



USAID
FROM THE AMERICAN PEOPLE

**MUNICIPAL FINANCE STRENGTHENING
INITIATIVE (MFSI-II) ROLL-OUT**

Quarterly Report
01 April 2013 - 30 June 2013

Prepared by IBSER for grant
AID-121-A-11-00006

Kyiv

07/15/2013

Abbreviations

AFO	Association of Financial Officers of Ukraine
AUC	Association of Ukrainian Cities
CLC	Commercial Law Center
CPER	Combined Program Evaluation and Review
DHA	District Heating Assessment
EC	European Commission
ESCO	Energy Servicing Company
EU	European Union
FAF	Foreign Assistance Framework
GOU	Government of Ukraine
HCSS	Housing and Communal Services Sector
IBSER	Institute for Budgetary and Socio-Economic Research
LG	Local Government
LINC	Local Investment and National Competitiveness
MBR	Municipal Budget Reform
MFF	Municipal Finance Facility
MFSI	Municipal Finance Strengthening Initiative
MOF	Ministry of Finance
MOU	Memorandum of Understanding
NGO	Non-Governmental Organization
OSR	Own-source Revenues
PFR	Public Finance Review
PMP	Performance Monitoring Plan
PPB	Performance Program Budgeting
RTI	Research Triangle Institute
SEFR	Support for Economic and Fiscal Reform
TSA	Treasury Single Account
USG	United States Government
WB	World Bank



Executive Summary

- MFSI-II experts have piloted the methodology of comparative analysis of budget programs based on the reporting data of local budgets. More than 750 budget programs of oblast, raion, and city budgets, which were implemented in 2012, have been evaluated. Based on the results, the MFSI-II experts have prepared their proposals with regard to the methods of monitoring and evaluation of performance of the local PPB-based budget programs and submitted them for consideration to the Ministry of Finance of Ukraine.
- MFSI-II experts have developed proposals with regard to amending the MOF Order of 9 July 2010, No.679, which approves the main approaches to realization of budget programs. The draft amendments take into account special features of PPB formation of local budgets on a permanent basis rather than as an experiment. MFSI-II experts have developed a standard program classification of expenditures and crediting of local budgets and a comparative table of its correspondence to the existing provisional classification of expenditures and crediting of local budgets. New approaches to program classification of local budgets were approved at a joint meeting of the Task Force on interbudgetary relations reform and the National Advisory Board on effective management of public finance, which took place on 25 June 2013. The meeting participants recommended that the appropriate amendments should be made to all the documents used in the budget process.
- MFSI-II experts delivered a series of trainings on PPB implementation at the local level for raions. April through June 2013, ten one-day trainings on PPB implementation at the local level were organized. A total of 936 local-level specialists passed through training in the reporting quarter. This training made it possible to prepare all the raion budgets based on PPB for the first time in 2013. More than 35,000 budget programs were developed in the first six months.
- The Project delivered its first workshop for local specialists at the Center for Upgrading the Qualifications of Executive Cadre at the Odesa Regional Public Administration Institute of the National Academy of Public Administration under the President of Ukraine (ORIDU NADU under the President of Ukraine). The workshop included four sessions and was held on 11-16 March 2013.
- Meetings of the Interbudgetary Relations Reform Task Force, which were attended by MFSI-II experts, took place on 26 April 2013 and 27 May 2013. The participants discussed the progress in implementing the activities of the 2013 National Action Plan for introducing the Program of Economic Reforms for 2010-2014, including implementation of PPB at the local level.
- Analysis of the Budget Declaration for the next year is prepared and the suggestions to the document are accepted and incorporated in the text of the document. Experts of the MFSI-II Project have analyzed the Draft Main Directions of the Budget Policy for the Year 2014 prepared by the Verkhovna Rada Committee. The Verkhovna Rada failed to approve the document on time (according to the Verkhovna Rada Rules of Procedure, the approval should have taken place on 30 April latest). At this time, the Draft is still under consideration at the Verkhovna Rada of Ukraine.
- As part of realization of the MFSI-II Project, a Memorandum of Cooperation was signed with the Center for Retraining and Qualifications Improvement of the Staff of Government Authorities, Local Governments, State Enterprises, Institutions, and Organizations of the Kirovohrad Oblast State Administration State educational institution. The common objective of the parties is collaboration in conducting training on implementation of PPB methodology at the local level.

Also, the IBSER consultants continued delivering training sessions for local specialists at the Center for Qualification Improvement of the Leading Cadres of the Odesa Regional Institute of Public Administration of the National Academy of Public Administration under the President of Ukraine (ORIDU NADU under the President of Ukraine). The trainings were conducted on 14 and 29 June 2013.

- The Project presented Recommendations on financial incentives to promote the establishment of an effective energy savings system in the public sector at the 11th Financial and Economic Forum on April 5, 2013. The Recommendations indicate that the incentives should be an integral part of a comprehensive mechanism when managing the funds saved in energy costs. Such an approach would help address several important issues: (1) providing incentives to reduce energy consumption; (2) targeted use of the saved funds, where either borrowed funds or energy service companies were engaged in project implementation; (3) increasing funds for energy saving activities.
- To facilitate practical application of the above-mentioned Recommendations, the MFSI-II experts provided consultations to the city of Zhytomyr with regard to the Procedure of using the funds saved in utilities and energy costs. The MFSI-II experts helped to prepare a draft Zhytomyr City Council resolution approving this Procedure. The City Council's approval of this document will make it possible for the city to identify, accumulate, and use funds saved in energy costs. In general, the procedure of saving funds developed by the MFSI-II experts will facilitate establishment of an effective energy saving system in the city of Zhytomyr.
- MFSI-II experts provided consultations to the staff of Ivano-Frankivsk municipal utility on using the methodology of monitoring and evaluating of the energy performance projects and improving the efficiency of the financial justification of strategic documents by municipal utilities. The experts have developed and provided recommendations, with regard to:
 - strengthening the linkage between the municipal utility strategy and the municipal energy plan for 2011-2015 and the Program of reform and development of city's housing and communal services sector for 2011-2015 entitled *Reforms, Order, Development*;
 - improving the financial justification of the Strategic Plan in general, and on other matters.
- MFSI-II experts updated the system for monitoring energy-related budget expenditures for the five selected cities: Lutsk, Alchevsk, Ternopil, Myrhorod and Vinnytsya. The new system has been updated to comply with the most recent modifications in the budget laws of Ukraine. It contains a new section with regard to the methodology of indicator calculation with due account for changes in the temperature of ambient air. This indicator is vital, since such changes have a direct impact on measuring the amount of real savings. In addition, the improved system contains an optimal number of calculation indicators. Thanks to incorporation of the above-mentioned methodology and optimization of the calculation section, the MFSI-II experts have made this system more user-friendly for specialists of local councils and, at the same time, more effective for monitoring and evaluation.
- In the reporting timeframe, the Project prepared three monthly monitoring reports on the implementation of State and local budgets for the period from February 2013 to April 2013.
- According to the Treasury's preliminary data, the Project prepared "Budget Monitoring for January-March 2013." The monitoring included an analysis of the latest trends regarding State and local budget execution, as well as an analysis of the legislative acts approved during the reporting period which influenced the budget process.
- The Eleventh Financial and Economic Forum on the topic of Energy Efficiency of Budget Expenditures as a Road to Economic Prosperity was held on 5 April 2013. In the course of the Forum, the participants reviewed and discussed the topical issues related to the legal foundations and modern practices of implementation of energy saving projects, mechanisms of financial



incentives for efficient use of energy resources, and alternative funding sources for energy saving projects, as well as the ways of strengthening the financial capacity of local budgets and improving the investment attractiveness of cities and towns.

- On 25 June 2013, the Ministry of Finance held a joint meeting of the Task Force on interbudgetary relations reform and the National Advisory Board on effective public finance management. The meeting was attended by the Ministry of Finance, State Treasury Service, MFSI-II Project, academia, NGOs, and international organizations. The participants discussed issues related to improving the regulatory and methodological framework of PPB application at the level of local budgets, as well as the results of a pilot project on the methodology of comparative analysis of efficiency of budget programs.

List of major activities for the next quarter

- MFSI-II experts and the Ministry of Finance of Ukraine will continue working together to implement the Performance Program Budgeting method at the level of local budgets as part of the budget reform pursuant to the Program of Economic Reforms for the year 2010-2014 entitled "Prosperous Society, Competitive Economy, Effective Government."
- IBSER will provide organizational support to the Ministry of Finance Intergovernmental Working Group and organize its meeting in September 2013.
- MFSI-II experts will prepare recommendations for the Government of Ukraine for regulating the issues related to the potential impact on the natural environment and public health in new PPB program documents and legislation.
- By the end of the next quarter, it is planned to prepare three monthly monitoring reports on the implementation of the State and local budgets for the period from May 2013 to July 2013.
- MFSI-II experts will update training course of System for monitoring energy-related budget expenditures and will prepare report on the number of trainings held and the number of specialists who participated in trainings with a breakdown by gender.
- MFSI-II experts will provide consultations to cities on Recommendations on financial incentives to promote the establishment of an effective energy savings system in the public sector.
- MFSI-II experts will provide consultations to the staff of municipal enterprises on using the methodology of monitoring and evaluating of the energy performance projects and improving the efficiency of the financial justification of strategic documents by communal service enterprises.
- By the end of the next quarter, MFSI-II experts plan to prepare the *Budget Monitoring for January-June 2013*.
- The preparation and organization of a National Advisory Board meeting is scheduled for September 2013.

Key Milestones and Major Deliverables Summary

Objective A: Provide legislative, methodological and organizational support to central and local government bodies to expand PPB to all local budgets in Ukraine

- Proposals that amend the regulatory and legislative framework as needed to complete PPB implementation for district budgets developed

Timeline: January – June 2013

- The proposals for improving the existing reporting forms, as well as new forms for the treasury servicing of PPB-based budgets developed

Timeline: January – June 2013

- Delivering a series of cluster trainings on PPB budgeting

Timeline: January – June 2013

- Working Group

Timeline: April 26, May 27, June 25, 2013

Sub-objective A.1: Ensure institutional sustainability of the PPB training program(s).

- Report on the number of trainings held and the number of participants attending the trainings with a breakdown by gender

Timeline: June 14 and 29, 2013

Objective B: Develop and introduce financial practices that foster energy efficiency in 15 selected cities.

- Consultations on financial incentives to promote the establishment of an effective energy savings system implementation provided to the cities, including for development of budget programs and individual investment projects

Timeline: April – September 2013

- Consultations to the staff of municipal enterprises on using the methodology provided

Timeline: January – September 2013

Objective C: Enhance public awareness of the public budgeting process, revenues and expenditures

- Monthly monitoring of national and local budget implementations

Timeline: second week of every month

- Monitoring of the budget and fiscal impacts on local budgets in form of a full-scale analysis of the budget process

Timeline: June 30, 2013

- Preparation and organization of Financial-Economic Forum

Timeline: April 5, 2013

- Preparation and organization of the National Advisory Board

Timeline: June 25, 2013

- Preparation of Electronic bulletin

Timeline: April, 2013

Tasks and Subtasks

Objective A: Provide legislative, methodological and organizational support to central and local government bodies to expand PPB to all local budgets in Ukraine

Task 1.1: Provide assistance to the GOU (Ministry of Finance, State Treasury of Ukraine, local finance departments, key spending units, specifically) in conducting state-supported pilot programs on Performance Program Budgeting (PPB) and their implementation in local budgets in Ukraine

Sub-task 1.1.1: Develop and formalize system to monitor and evaluate execution of local budget programs for all local government functions

During the first year of project implementation, IBSER developed the draft methodology for monitoring and evaluation of the efficiency of budget program performance (including energy saving actions and the improvement of the natural environment). The methodology was considered at a meeting of the NAB on December 28, 2011, which was attended by members of Parliament, experts of the Verkhovna Rada Budget Committee and other parliamentary committees, Ministry of Finance, and local governments.

The revised methodology was submitted in January 2012 to the Ministry of Finance. The work is currently in progress to finalize and improve the methodology.

Deliverable: Report on the results of the monitoring and evaluation of the performance of PPB-based budget programs (if the methodology is approved and implemented)

Timeline: March 2013

MFSI-II experts have developed the methodology of comparative analysis of efficiency of budget programs. The Ministry of Finance approved the said methodology and communicated it to all project participants (MOF Letter of 13 February 2013, No.31-05010-14-8/4651). MOF recommended its use to all spending units of local budgets when evaluating the efficiency of budget programs.

The methodology provides for identifying the same criteria for the degree of efficiency for typical budget programs, allows unifying the implementation of efficient evaluation for all spending units of budget funds, as well as uses the same algorithm for the calculation based on a formula approach. This allows automating the preparation of information on the evaluation results and ensuring comparability of evaluation results in all required cross-sections.

Application of a single methodology allows obtaining an unbiased evaluation of efficiency of budget programs both by key spending unit within the same local budget, and by different local budgets.

It will be used by the project participants for the first time when evaluating efficiency of the budget programs which were implemented in 2012.

Accomplished (see “Quarterly Report 01 January – 31 March, 2013”)

MFSI-II experts have piloted the methodology of comparative analysis of budget programs based on
--

reporting data of local budgets. More than 750 budget programs of oblast, raion, and city budgets executed in 2012 passed through this evaluation. The results were presented by MFSI-II experts at a joint meeting of the Interdepartmental Working Group and the National Advisory Board on effective management of public finance, which took place on 25 June 2013.

This work has resulted in drafting proposals for improving the methodology of comparative analysis of budget programs. In addition, a decision was made to automate the evaluation according to the methodology prepared by MFSI-II experts and incorporate such functionality in the software being developed by MOF for local finance departments.

See folder “Deliverables”

Deliverable: Proposals for improving the methods of monitoring and evaluation of performance of the local PPB-based budget programs

Timeline: January – March 2013

The participants in the NAB meeting of 29 March 2013 decided to test the methodology of comparative analysis of efficiency of budget programs based on the 2012 local budget reporting data. Subject to evaluation will be the budget programs of individual oblast, district, and city formulated based on PPB in 2012.

The results obtained in the course of testing this methodology will be used by MFSI-II experts to prepare their proposals regarding the methods of monitoring and evaluation of performance of the local PPB-based budget programs and submit them for consideration to the Ministry of Finance of Ukraine.

Accomplished (see “Quarterly Report 01 January – 31 March, 2013”)

Based on the results of the comparative analysis, the MFSI-II experts have prepared their proposals with regard to the methods of monitoring and evaluation of performance of the local PPB-based budget programs and submitted them for consideration to the Ministry of Finance.

See folder “Deliverables”

Sub-task 1.1.2: Complete the legislative, regulatory and methodological framework taking into account the specifics of PPB implementation at various levels of local budgeting

In order to implement the State support of the PPB methodology for all oblast, rayon and oblast-significant municipal budgets, IBSER will:

- assist in developing proposals that amend the regulatory and legislative framework as needed to complete PPB implementation for district budgets.
- prepare draft amendments to the joint orders of MOF and line ministries that approved the standard lists of budget programs and their performance indicators for all functions of local budgets.
- prepare updating (if needed) the instruction on using the program classification of expenditures and crediting of local budgets and the standard codifier of local budget programs.
- develop recommendations for the Government of Ukraine for regulating the issues related to the potential impact on the natural environment and public health in new PPB program documents and legislation.

Deliverable: Proposals that amend the regulatory and legislative framework as needed to complete PPB implementation for district budgets developed

Timeline: October 2012 – September 2013

MFSI-II experts continue their ongoing work to improve the regulatory and legislative framework required for PPB implementation in local budgets of all levels.

The Ministry of Finance of Ukraine issued two orders to amend the MOF Order of 14 February 2012, No. 97. These orders incorporate all the proposals made by MFSI-II experts with regard to amending the Structure of the code of program classification of expenditures and crediting of local budgets and the Codifier of budget programs of local budgets. In particular, the Code of program classification has been supplemented by the Subprogram option, the "budget program code" option is introduced, and all modifications enacted by the previously issued orders of MOF and line ministries are incorporated.

In addition, the proposals of MFSI-II experts are incorporated in the MOF Order dated 23 November 2012 "On amending the Order of the Ministry of Finance of Ukraine of 09 July 2010, No. 679," which approves the main approaches to implementation of the Performance Program Budgeting method of compilation and execution of local budgets.

The approved amendments will:

- simplify the procedures of budgeting in formulation of local budgets thanks to reduction in the number of budget programs and the performance indicators in these departments;
- raise the level of efficiency in managing the budget process thanks to reducing the time for the formulation of PPB-based budgets;
- increase the transparency of PPB-based budget formulation.

Accomplished (see "Quarterly Report 01 October – 31 December, 2012")

MFSI-II experts have drafted amendments to the MOF Order dated 09 July 2010, No.679, which approves the main approaches for implementation of budget programs. The draft amendments take into account special features of PPB budgets formulation on a permanent basis rather than as an experiment. Accordingly, modifications to the rules of compilation of local budget program passports are being developed, as well as the quarterly and annual reports on their execution.

Deliverables: Drafts amendments to joint orders of the Ministry of Finance and line ministries that approved standard lists of budget programs and their performance indicators

Timeline: October – December 2012

Amendments have been enacted to the Standard lists of budget programs and performance indicators for the delegated functions in the departments of *Public administration, Social protection and social security, Social protection of family and children, and Physical culture and sport*, as well as similar provisions for the disbursement of expenditures for implementation of own functions of local budgets. The said amendments have been approved by orders of the Ministry of Finance of Ukraine and line ministries. In addition, the experts provided their proposals to modify the Standard lists of budget programs and the performance indicators for the expenditures in the departments of youth and culture.

The issued orders incorporate all the proposals made by MFSI-II experts with regard to reducing the number of budget programs and their performance indicators. The introduced amendments will significantly simplify the budgeting process and raise the level of efficiency in managing the budget process.

Accomplished (see "Quarterly Report 01 October – 31 December, 2012")

Deliverables: An updated instruction on using the program classification of expenditures and crediting of local budgets and the standard codifier of local budget programs prepared (if needed).

Timeline: April – June 2013

MFSI-II experts developed a standard program classification of expenditures and crediting of local budgets and a comparative table of its correspondence to the existing provisional classification of expenditures and crediting of local budgets.

The code structure of program classification of local budgets were also modified, which fully corresponds to the structure of program classification at the State budget level.

Approval of the new classification will make it possible to start using it and introducing a fully functional formulation and execution of local budgets based on PPB since 1 January 2014.

Besides, the proposed changes would allow to unify the reporting and accounting procedures both at the national and local levels, and for the first time summarize the reports of local budgets prepared in the PPB format.

New approaches to program classification of local budgets were approved at a joint meeting of the Task Force on interbudgetary relations reform and the National Advisory Board on effective management of public finance, which took place on 25 June 2013. The meeting participants recommended to make appropriate modifications to all documents used in the budget process.

See folder “Deliverables”

***Deliverables:** The recommendations for the Government of Ukraine for regulating the issues related to the potential impact on the natural environment and public health in new PPB program documents and legislation.*

***Timeline:** July – September 2013*

Sub-task 1.1.3: Develop formats and procedures for treasury-based services of local budgets to improve the budget software used by the State Treasury; field-test these products within the local governments that have been a part of the pilot program

IBSER will provide technical support for improving the formats and procedures of treasury servicing of local budgets. It will support the implementation of the preparatory work needed for introducing the generation of reports on the execution of local budgets based on the codes of program classification of expenditures and crediting of local budgets.

During the first year of project implementation, the MFSI-II experts have reviewed the existing reporting forms on execution of local budgets, which are compiled by the State Treasury of Ukraine. The analysis has shown that these reports need amending in the context of PPB budgeting, namely: it is necessary to take into account the special circumstances of execution of local budgets using the codes of program classification of expenditures and crediting of local budgets.

The special features in generation of reports according to PPB were brought for consideration of the members of the National Advisory Board on efficient public finance management and approved at the meeting of 27 April 2012. Based on the results of this work, the IBSER proposals for improving the reporting forms on execution of local budgets, which are compiled by the State Treasury Service of Ukraine, have been developed and submitted to the Ministry of Finance of Ukraine.

Next year, should amendments be made to the PPB methodology for local budgets, IBSER shall:

- carry out a new review the existing reports on the execution of local budgets used by the Treasury and draft its proposals with regard to their amendment in the context of PPB.
- prepare its proposals for improving the procedures for the treasury servicing of local budgets. It will submit its proposals with regard to such amendments to the legislative framework that defines Treasury functions.

- develop proposals for the requirements specification to improve the budget software used by the State Treasury and assist with its field-testing after installation in the pilot regions.

Deliverables: The proposals for improving the existing reporting forms, as well as new forms for the treasury servicing of PPB-based budgets developed

Timeline: January – June 2013

MFSI-II experts continue their work toward improving the existing reporting forms on the execution of local budgets. Thus, the proposals of MFSI-II experts were incorporated into the modification of forms of financial and budget reports on execution of local budgets approved by Order No.14 of the Ministry of Finance of Ukraine dated 16 January 2013.

To ensure the unity of the budget process in Ukraine and adapt the budget reports to PPB, the MFSI-II Project experts have proposed to modify the program classification and the provisional classification of local budget expenditures. Further elaboration of the classifications is essential for them to be used starting in 2014 for the formulation and execution of PPB-based local budgets. They have also suggested to make appropriate changes to the forms of the State Treasury reports on execution of local budgets.

The abovementioned issues were discussed on 6 March 2013, in the course of a working meeting between the MFSI-II experts and specialists of the State Treasury Service of Ukraine, and approved at a meeting of the National Advisory Board (NAB) on effective public finance management.

The proposed changes will ensure the compilation of reliable and transparent reports based on PPB by offices of the State Treasury Service.

Accomplished (see “Quarterly Report 01 January – 31 March, 2013”)

A working meeting between MFSI-II experts and specialists of the State Treasury Service took place on 14 June. During the meeting, its participants discussed the MFSI-II proposals aimed at improving the reporting forms on execution of local budgets. Such improvement of reporting forms is based on the changes to classification of expenditures developed by MFSI-II experts.

Introduction of new reporting forms and changes to classification of local budget expenditures as of 1 January 2014 will improve the treasury servicing of local budgets and ensure a transparent generation of reports in the PPB format.

Common approaches to the formation of the State and local budgets and their automation will improve the transparency of the budget process and strengthen controls over management of budget funds.

In addition, the topical issues of improving the treasury servicing of PPB budgets were discussed at a joint meeting of the Task Force on interbudgetary relations reform and the National Advisory Board on the issues of effective management of public finance held on 25 June 2013. The meeting participants approved the proposals made by MFSI-II experts with regard to conceptual changes in the classification of expenditures and crediting of local budgets, which would allow to carry out the treasury servicing of budgets in accordance with the PPB requirements.

See folder “Deliverables”

Deliverables: The proposals for improving the procedure for the treasury servicing of local budgets developed. The proposals with regard to amendments to the legislative framework, which defines Treasury functions developed

Timeline: October – December 2012 and July – September 2013

MFSI-II experts continue working on improving the procedures of treasury servicing of local budgets.

The Order of the Ministry of Finance dated 25 November 2012, No. 1126 “On amending the Order of the Ministry of Finance of Ukraine of 30 January 2012, No. 60” approved amendments to the forms of budget reports on execution of local budgets, which incorporate the proposals made by MFSI-II experts with regard to improving the existing reporting forms on execution of local budgets.

In addition, at a meeting of the National Advisory Board on the issues of effective public finance management on 25 December 2012, the participants reviewed the experts' groundwork with regard to further ways of improving the treasury servicing of PPB-based local budgets.

Accomplished (see “Quarterly Report 01 October – 31 December, 2012”)

Deliverables: The proposals for the requirements specification to improve the budget software used by the State Treasury developed

Timeline: October 2012 – September 2013

On 23 January 2013, as part of operations of the Interdepartmental Working Group on execution of activities on the National Action Plan, a working meeting was held on implementation of the Performance Program Budgeting method of formulation and execution of local budgets.

The meeting participants discussed the proposals made by MFSI-II experts regarding the approaches and directions for further improvement of the regulatory and methodological framework. These changes will be realized when finalizing the software for the State Treasury servicing of PPB-based local budgets, their execution, and generation of consolidated reports.

These changes will provide legislative regulation for the procedure of execution of PPB-based local budgets and will ensure the compilation of reliable and transparent budget reports.

Accomplished (see “Quarterly Report 01 January – 31 March, 2013”)

Upon a suggestion from MFSI-II experts, the issues of improving the software for treasury servicing of the local budgets formulated according to PPB were considered at meetings of the Task Force on interbudgetary relations reform on 26 April and 27 May 2013.

Discussed at the meetings were the proposals made by MFSI-II experts, which would allow implementing the treasury servicing of budgets in accordance with the PPB requirements, as well as the ways of their realization in the State Treasury Service software.

Based on the results of the meetings, the specialists laid down the approaches for amending the classification of expenditures and crediting of local budgets. They also reviewed modifications to the forms of individual documents to be used in the process of PPB-based local budget planning and execution. Based on these documents, it is necessary to carry out further development of the software in terms of expanding its functionalities for treasury servicing of the local budgets, which use the Performance Program Budgeting method, and for generating the financial and budget reports.

Solution of these issues will guarantee for using appropriate software when planning, approving, and executing PPB-based local budgets since 2014.

See folder “Deliverables”

Sub-task 1.1.4: Prepare and disseminate a PPB hand book

During the first year of project implementation, the MFSI-II experts prepared a Modern Tools of Financial Planning Handbook, which contains the training, normative, and methodological materials needed for learning the methods and applying the practices of local budget planning based on Performance Program Budgeting. The methodology of financial justification of strategic documents and principles of financial analysis of investment projects are provided.

Should any significant changes be made in the methodological framework of Performance Program Budgeting for local budgets, this publication would be amended accordingly. An updated version of the Modern Tools of Financial Planning Handbook will be posted on the MFSI-II web page and disseminated during PPB trainings.

Deliverable: *The PPB Handbook improved due to changes in legislation (if needed), disseminated, and published on the website*

Timeline: *October – December 2012*

MFSI-II experts have prepared an updated version of the *Planning of Local Budgets Based on the Performance Program Budgeting Method* handbook, which contains the training, normative, and methodological materials required for studying the methods and applying the practices of local budget planning based on the Performance Program Budgeting method. This handbook reflects all the latest changes in the PPB legislation.

Its use will help improve the knowledge of local-level specialists about the modern tools of financial planning. This handbook will be disseminated during PPB trainings for district-level specialists.



Accomplished (see “Quarterly Report 01 October – 31 December, 2012”)

Sub-task 1.1.6: Train at least 8,000 budget officers from local finance departments, key spending units, as well as territorial departments of the Treasury

In order to efficiently implement PPB at the local level, it is necessary to improve the qualifications of the personnel of local finance departments, the specialists of the spending units and recipients of budget funds, as well as of the representatives of regional and local offices of the State Treasury.

At the regional level, during the second year of MFSI-II project implementation, IBSEER will deliver a series of cluster trainings, which will cover more than 2,000 rayon-level specialists. Thus, since the project launch, the MFSI-II experts have conducted a series of similar PPB trainings. Such trainings were delivered in all oblast centers for specialists of each region, which joined the experiment in 2012. Overall, 2,950 local-level specialists passed through this training, including 2,314 women and 265 men.

Deliverable: *Report on the number of trainings held and the number of participants attending the trainings with a breakdown by gender*

Timeline: *April – December 2012, July – September 2013*

With support from the Ministry of Finance of Ukraine, IBSEER has completed delivery of regional meetings/consultations for participants of the PPB implementation experiment. In October and November, these meetings were held in Lviv, Kharkiv, and Rivne. The meeting participants shared their experience of PPB implementation in local budgets, considered the practical aspects of realization of



Phase III of PPB implementation, and were familiarized with the directions for optimization of PPB budgeting at the local level.

In addition, upon request of the Kyiv City State Administration, MFSI-II experts took part in a meeting/training for specialists of municipal institutions, enterprises, and organizations of the city of Kyiv held on 31 October 2012. Among other things, the experts made a detailed presentation to the participants of the special features of PPB implementation in the budget process and PPB use as a tool for evaluating the institutional performance efficiency.

Such meetings were attended by 108 sub-national government entities in the reporting period (See PMP).

As seen from the results of evaluation of experiment's performance in 2012, the number of budget programs approved by local budget resolutions amounts to more than 31,000. In addition, the economy of budget funds totaled UAH 256.0mn as of 1 November 2012, which amounts to 74.9% of the annual plan. These results testify to the effectiveness of the training delivered.

Accomplished (see "Quarterly Report 01 October – 31 December, 2012")

MFSI-II experts have launched a series of trainings for districts on PPB implementation at the local level. Four one-day trainings on PPB implementation at the local level for specialists from the Kyiv and Luhansk oblasts were delivered in November and December 2012. PPB implementation coordinators from each region and specialists of the structural units of District Finance Directorates in charge of the formulation of departmental indicators of respective budget were engaged in the trainings. More than 200 local-level specialists passed through this training in the reporting period (See PMP).

Accomplished (see "Quarterly Report 01 October – 31 December, 2012")

MFSI-II experts continued delivering a series of training events for new participants of PPB implementation at the local level. In January - March 2013, 14 one-day trainings on PPB implementation at the district budget level were organized. Such training events were delivered for the specialists from the Odesa, Sumy, Khmelnytskyi, Poltava, Chernivtsi, Cherkasy, Zaporizhzhya, Ivano-Frankivsk, Ternopil, and Kharkiv oblasts. Altogether, 1,078 local-level specialists passed training in the reporting quarter, with 1,279 specialists who passed training in Q1 of the Year II of MFSI-II Project (See PMP).

Accomplished (see "Quarterly Report 01 January – 31 March, 2013")

MFSI-II experts have completed a series of trainings for raions on PPB implementation at the local level. Ten one-day trainings on PPB implementation at the local level were organized in April - June 2013. Such trainings were conducted for specialists from the Volyn, Chernihiv, Kirovohrad, Rivne, Mykolaiv, Kherson, and Zakarpattya oblast. Engaged in the trainings were the PPB implementation coordinators from each of the regions and specialists of the structural units of raion Finance Directorates in charge of the formulation of departmental indicators of respective budgets. Also, the trainings were attended by representatives of the State Treasury Service of Ukraine. All in all, 936 local specialists passed through training in the reporting quarter, with 2,215 specialists trained since the beginning of Year II of the MFSI-II Project (See PMP).

Regional training on implementation of the Performance Program Budgeting method of planning and execution of local budgets, the city of Mykolaiv 23 April 2013





These trainings made it possible to formulate all the raion budgets based on PPB for the first time in 2013. More than 35,000 budget programs were formulated in the first six months of the year. Thus, all the budgets of oblast-significant cities, oblast and raion budgets (692 local budgets, see PMP) will be transferred to this modern planning method, which would allow generating a beneficial social and economic impact from utilization of budget funds.

Regional training on implementation of the Performance Program Budgeting method of planning and execution of local budgets, the city of Uzhhorod 25-26 April 2013



See folder “Deliverables”

Sub-task 1.1.7: Conduct training sessions for relevant public budget officers on the following issues:

- ***Designing effective development budget programs;***
- ***Linking local economic development strategies and plans to available governmental and non-governmental resources;***
- ***Conducting sound financial analysis and developing credible investment and project financing proposals;***
- ***Incorporating financial and economic analysis in the preparation of local strategic documents.***

To assist local governments in applying credible financial analyses and projections to estimate the costs of local developmental strategies and individual projects and identify the sources of funding, IBSER will prepare a draft bylaw with regard to medium-term budgeting at the local level.

In order to provide quality methodological support to the delivery of trainings, IBSER will develop the relevant methodology and modules for PPB training materials. These modules will contain, among other things, recommendations for local governments that address the environmental protection and healthcare problems in their strategies and development budget programs, as well as the methodology of medium-term budget projection. IBSER will present a draft module for DIALOGUE project and will take into consideration its feedback.

- IBSER will develop the proposals into a draft bylaw on medium-term budgeting at the local level.
- IBSER will develop a methodology of financial justification of strategic documents. This methodology will provide for linking local economic development strategies and plans to available governmental and non-governmental resources, as well as incorporating financial and economic analyses in the preparation of local strategic documents. As the result, local budgets will have sufficient resources to support all essential local government functions.
- IBSER will develop a separate module on using the methodology of financial justification of strategic documents as part of PPB training materials (see Sub-task 1.1.4).
- IBSER will develop a module on designing effective development budget programs and conducting a sound financial analysis and developing credible investment and project financing proposals, as part of PPB training materials (see Sub-task 1.1.4).

Result/Deliverable: Draft bylaw on medium-term budgeting at the local level

Timeline: January - March 2012

The Order of the Ministry of Finance of Ukraine of 6 June 2012, No. 687 “On approving the Instruction on preparation of budget requests” contains the proposals of MFSI-II Project experts developed under this task with regard to the methodology of cost and credit provision for the planning year and two subsequent budget years by key spending units of local budgets.

Thus, the Instruction requires that the calculation of ceilings and indicative forecast indicators should be carried out, among other things, with due account to the following:

- the subsistence level and the level of its provision;
- the minimum wage amount and official pay rate of Tariff Grade I employee under the Unified Tariff Pay Scale of Grades and Coefficients for remuneration of the staff of institutions, establishments, and organizations in individual departments of the budgetary sphere;
- forecast prices of energy and tariffs for communal services;
- the need for inclusion of new (compared to the current budget period) priority expenditures, including those of periodical nature;
- the need for optimization of costs incurred by key spending units, including by means of concentration of resources in the priority areas, reduction of any secondary and exclusion of inefficient costs etc.

Also, the Instruction stipulates that a key spending unit shall allocate the ceiling and indicative forecast indicators by budget program with due account for the priorities of country’s socioeconomic development its activities are intended to implement and the strategic objectives set out in its action plans for the planning year and two subsequent budget periods.

Calculation of the amounts of expenditures and credit provision for the planning and subsequent two budget periods according to the Instruction shall be carried out by key spending units, among other things, with due account for the following:

- normative-legal acts, which regulate activities of a key spending unit in a relevant department;
- obligations under agreements/contracts;
- norms and standards;
- periodicity of implementation of individual budget programs, as well as of the individual activities, which are being implemented as part of budget programs;
- the level of priority of expenditures, with due account for the real budget capacity;
- the results of evaluation of the efficiency of budget programs conducted with due account for the methodological recommendations on efficiency evaluation of budget programs set out by the Ministry of Finance, and the conclusions regarding the results of the supervisory actions taken by the bodies authorized to implement the supervision over observance of the budget law;
- prices and tariffs of the current year of the relevant goods (works, services) whose procurement is expected under a budget program;
- the quantity and cost drivers, which influence the amount of expenditures and credit provision in the planning and subsequent two budget periods.

It is also stipulated that the quantity drivers shall include, among others, the standard number of staff, number of students, number of budgetary institutions, number of disabled persons, pensioners etc. The cost drivers include consumer price indices and producer price indices, prices/tariffs of goods (works, services), subsistence level and the degree of its provision, the amounts of minimum wages and official pay rate of Tariff Grade I employee according to the Unified Pay Scale etc.

The amount of capital expenditures shall be determined taking into account the planned scope of works according to the construction documents, degree of construction readiness of facilities, quantity of the available equipment and durable goods, and the degree of their physical depreciation and obsolescence. The factors, which could be taken into account when determining the amount of capital expenditures, shall be determined by the key spending unit independently, with due account for special departmental conditions.

As regards the development of the medium-term forecast amount of expenditures for local budgets, the Ministry of Finance Letter of 23 November 2012 stipulates that the Instructions for preparation of budget requests shall be issued by local finance agencies in the form of orders. According to the Ukrainian rule-making practices, the local finance agencies will be using the above-mentioned Instruction at the national level as a template.

Accomplished (see “Quarterly Report 01 October – 31 December, 2012”)

Sub-task 1.1.8: Provide advisory support to those local governments that have not been involved in the PPB pilot project

- During the first year, IBSEER developed the existing local network of consultants who will help introduce PPB budgeting and will facilitate coordination between participants in the process. To implement the tasks of the second year of the project the consultants will collect, summarize, and submit for consideration by the Ministry of Finance the most important issues and promote the dissemination of recommendations for their resolution in the regions. To facilitate experience sharing among all the participants in the experiment and analyzing the progress of implementation of PPB budgeting, information from all the regions will be collected and processed on an ongoing basis. Best practices in PPB implementation will be highlighted on the MFSI-II website and in print publications.
- IBSEER will continue supporting the website section “Topical PPB Issues: Expert Answers column,” where visitors will be able to receive answers to their questions through interactive communication.

Deliverable: Annual experiment progress reports

Timeline: March 2013

To enable monitoring of the status and results of PPB implementation at the local level, all the participants have provided their information on the work completed as of 1 November 2012 (The Ministry of Finance Letter of 14 November 2012, No. 31-05010-14-8/27459 “On the status of PPB implementation at the local level”). Based on these data, MFSI-II experts have compiled a ranking by determining the percentage of implemented budget programs achieving expected results, reductions in the cost of local government services achieved due to PPB implementation, percentage of government units where regular budget program monitoring and evaluation is conducted (See PMP).

Also, the results of evaluation of the PPB implementation in local budgets were highlighted at a meeting of the National Advisory Board on the issues of effective public finance management on 25 December 2012.

Accomplished (see “Quarterly Report 01 October – 31 December, 2012”)

Also, according to the Ministry of Finance letter of 14 November 2012, No. 31-05010-14-8/27459 “On the Status of PPB Implementation at the Local Level,” information was gathered regarding the status and results of PPB implementation at the local level as of 1 January 2013. Using these data, MFSI-II conducted grouping and summarized the project’s results in implementation of PPB in 2012. Thus, the participants approved almost 31,700 budget programs, including 2,600 programs with indicators for economy of budget funds. Based on the results of their execution, savings of nearly UAH 410mn.

The summary on the monitoring of the status and results of PPB implementation at the local level was sent to the Ministry of Finance of Ukraine for consideration.

Accomplished (see “Quarterly Report 01 January – 31 March, 2013”)

Result/Deliverable: Running a column called «Topical Questions on PPB: Answered by Experts» on IBSER web-page

Timeline: monthly

New set of questions (twenty-four for the reported period) with experts answers related to PPB has been placed on the site, the information is regularly updated. In general, 116 answers to questions related to PPB have been prepared and posted on the website since the launch of the MFSI-II Project.

See folder “Deliverables”

Task 1.2: Review the legislation and analyze the execution of the State and local budgets of Ukraine. Provide support to operations of Interdepartmental Working Group

Sub-task 1.2.1: Advisory support to the interagency working group in finalizing the methodology, and the laws and regulations needed

- IBSER will provide organizational support to the Ministry of Finance's Intergovernmental Working Group by organizing meetings and developing the relevant recommendations regarding PPB methodology implementation.

Result: Meetings of the working group will be held on a regular basis

Deliverable: Developed recommendations

Timeline: November 2012, February 2013, May 2013, September 2013

On 19 October 2012, MFSI-II experts took part in a meeting of the Public Finance Reform topical working group chaired by the Director of the Department of Territorial Budgets Ye.Yu. Kuz'kin. The meeting concentrated on discussing the realization of actions in the 2012 National Action Plan. The meeting participants made a special focus on considering the issue of PPB implementation at the local level. In particular, the working group members discussed the matter of approval of budget programs by the participants of the PPB budgeting experiment. Based on the discussion results, the meeting participants provided their recommendations for summarizing the statistical information on the number of budgets and budget programs approved according to PPB.

In addition, the meeting participants noted the importance of efforts towards improving the Standard lists of budget programs and of amending the relevant regulations. MFSI-II experts are actively participating in this work, preparing their proposals and coordinating amendments to the normative-legal acts in collaboration with line ministries. The implemented work is reflected in the joint orders issued by MOF and other governmental ministries. Improving the Standard list will make it possible to reduce the number of budget programs and their performance indicators. This, in turn, will help increase the efficiency of formulation and execution of PPB-based local budgets, shorten the time required for preparing a PPB budget by specialists of local finance bodies. Thus, this will improve the budget process transparency, efficiency of using the budget funds and their economy. Achievement of the set objectives is fully in line with the goals and objectives of the MFSI-II Project.

Based on the results of the working group meeting, its participants have come to the conclusion about the need of continuing the work toward implementing PPB budgeting at the local level and have noted a high-level participation of IBSER in this process.

Accomplished (see “Quarterly Report 01 October – 31 December, 2012”)

On 23 January 2013, a working meeting on implementation of the Performance Program Budgeting method of formulation and execution of local budgets was held under the Interdepartmental Working Group on the issues of implementation of the National Action Plan.

The meeting was attended by MFSI-II experts, specialists of the Ministry of Finance of Ukraine and the State Treasury Service.

The meeting participants discussed the proposals of MFSI-II experts with regard to the topical issues of improving the treasury servicing of PPB-based budgets. In particular, this involved the issue of implementing the generation of reports on execution of local budgets based on the codes of program classification of expenditures and crediting of local budgets.

Based on the results of this meeting, the Ministry of Finance of Ukraine signed a protocol. This protocol has actually initiated a new phase in PPB implementation at the local level. Phase I was aimed at creating the legislative foundations and piloting the planning of PPB-based local budgets. At the same time, the said protocol launched the activities of building a methodological framework, which would regulate the execution of local budgets in the PPB format. This primarily applies to the State Treasury servicing of local budgets and generation of consolidated reports.

Addressing these issues will make it possible to ensure transparency in execution of local budgets, improve the State Treasury procedures, and facilitate accessibility of budget information.

Accomplished (see “Quarterly Report 01 January – 31 March, 2013”)

On 26 April 2013, MFSI-II experts took part in a meeting of the Interbudgetary Relations Reform Task Force. The participants reviewed the progress in implementing activities of the 2013 National Action Plan with regard to implementation of the 2010-2014 Program of Economic Reforms, including PPB implementation at the local level. The meeting was also attended by representatives of the Ministry of Finance, Verkhovna Rada Committee on Budget, and the State Treasury.

The Task Force members noted effective work of MFSI-II Project experts towards implementation of the Performance Program Budgeting method of planning and execution of local budgets. Due to a timely and quality delivery of trainings by MFSI-II experts, in 2013 budget programs and budget program passports in all areas of using budget funds have been approved on time.

The Task Force members also set out the ways of speeding up the work of improving the software, which would allow automating the PPB-based planning of local budgets.

On 27 May 2013, a meeting of the Interbudgetary Relations Reform Task Force took place at the Ministry of Finance. The meeting focused on the topical issues of improving the treasury servicing of PPB-based budgets. During the meeting, MFSI-II experts proposed a conceptual approach to developing the modifications to the classification of expenditures and crediting of local budgets, which would allow conducting the treasury servicing of budget in accordance with the PPB requirements. Besides, the participants considered the issue of the status of preparations for pilot operation of the IAS Local Budgets software.

According to the meeting results, a decision was made to speed up the work of amending the classification of expenditures and crediting of local budgets and forms of certain documents to be used in the process of planning and execution of PPB-based local budgets. The pilot operation of the respective software will be organized on the basis of these documents.

The resolution of these issues will make it possible to ensure transparency of execution of local budgets, streamlined treasury procedures, and greater availability of budget information.

On 25 June 2013, a joint meeting of the Task Force on interbudgetary relations reforms and the National Advisory Board on effective management of public finance took place with support from MFSI-

II.

The meeting participants discussed the issues on improving the normative-legal and methodological framework of PPB application at the level of local budgets. In addition, they reviewed the outcome of piloting the methodology of comparative analysis of budget program performance and ways of its improvement. Based on the meeting results, the participants supported the new approaches to program classification of local budgets and recommended introducing appropriate modifications to all documents used in the budget process. They recommended that the State Treasury Service should make the relevant modifications to the software used for treasury servicing of local budgets.

See folder “Deliverables”

Sub-task 1.2.2: Help local governments assess draft laws affecting their revenues and resource allocation including the State Budget Bill to identify and mitigate potential risks for the local development

To implement this task, IBSER will carry out:

- analysis of the draft Budget Declaration for the next year;
- analysis of the provisions of the draft legislation aimed at amending the revenue base of local governments;
- analysis of the Budget Law for the respective year;
- analysis of the Changes to the Budget Law for the respective year is prepared and the suggestions to it are incorporated in the Law (if such changes are brought forward for consideration by the Verkhovna Rada);
- analysis of the Changes to the Tax Code, land laws, and other laws related to local budgets, which could affect their revenues and resources.

Result Analysis of the Budget Declaration for the next year is prepared and the suggestions to the document are accepted and incorporated in the text of the document

Timeline: April – June 2013

The Budget Committee of the Verkhovna Rada of Ukraine considered at its meeting of 22 May 2013 the Draft Main Directions of the 2014 Budget Policy submitted by the Cabinet of Ministers of Ukraine (Reg.No. 2769 of 10 April 2013). Based on the discussion results, the Committee on Budget made a decision to recommend that the Verkhovna Rada should approve the Draft Decree of the Verkhovna Rada of Ukraine “On the Main Directions of the 2014 Budget Policy” in a version finalized by the Committee on Budget. This document had been previously submitted for consideration of the Verkhovna Rada (No.2769-d of 28 May 2013), however, it was not approved in the first half of 2013. The MFSI-II Project experts have analyzed the above-mentioned Draft Decree.



The document envisages a 14.2% growth in nominal GDP, which is almost on par with the same indicator identified by consensus forecast as of April 2013¹, which equals 13.9%.

The amount of consolidated budget revenues is estimated at UAH 482.9bn (30.0% of GDP) (see Chart 1). Such gain is on the whole in line with the expected general pace of economy's development in 2014, in particular, as regards the GDP growth.

It is planned to reduce the State budget deficit in GDP down to 3.0% compared to the 2013 target of 3.4%, and 2012 actual figure of 3.8%. This has to ensure a continued trend to alleviating the debt burden on the budget in subsequent years. At the same time, it should be noted that the 2013 Main directions of the budget policy set this indicator at 0.8-1.0%.

Financing of the State budget General Fund deficit is to be ensured mainly through internal borrowing. This situation is also observed this year, when the planned internal borrowing for the General Fund is 2.5 times more than external borrowing.

Improving the level of justification of budget planning at the local level by setting correlation links between budget indicators and strategic objectives of socioeconomic development of territories and introduction of medium-term planning of local budgets is one of the ways for development of the regions. In order to implement this, development of a methodological framework for such planning both at the State budget level and the local level is required.

MFSI-II experts note that the document contains certain proposals developed by participants of the Eleventh Financial and Economic Forum (Financial and Economic Forums are held within the framework of the MFSI-II Project), in particular, with regard to:

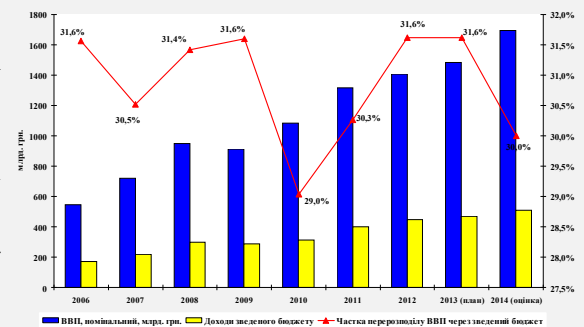
- increasing the proportion of local budget revenues in the consolidated budget;
- expanding the base for the tax on property other than land;
- the need for strengthening the financial capacity of local budgets;
- engaging private companies in the service provision and upgrading the infrastructure of the housing and communal services sector, in particular, through the legislative regulation for introduction of ESCO mechanisms.

At the same time, MFSI-II experts point to certain risks in the document. In particular, this applies to the declared National Regional Development Fund at the amount of not less than 1.0% of the estimated revenues of the General Fund of the State budget. In fact, the 2013 budget allocates less than UAH 1.3bn, whereas based on the projected revenues of the General Fund of the State budget, it should amount to more than UAH 3.0bn. Besides, in order to ensure consistent financing of medium- and long-term programs/projects of regional development, introduction of a medium-term budget planning for the Regional Development Fund is necessary.

Similarly to the last year, the Draft Decree has a number of deficiencies:

- 1) absence of an analysis of the results, which characterizes the level of implementation of the tasks set for the previous budget period, identifying the reasons for nonperformance of tasks and relevant conclusions, as well as a clear sequence in implementing the policies for achievement of concrete results;
- 2) vagueness of tasks, which contain no description of concrete actions, which need to be implemented by participants in the budget process;
- 3) a limited scope of quantitative and qualitative indicators, which could be used for analyzing the level of implementation of tasks (existing indicators only for the budget deficit, ceiling for the State debt and guarantee provision, percentage of consolidated budget redistribution through GDP, and key

GDP, Consolidated Budget Revenues, and Share of GDP Redistribution via Consolidated Budget in 2006 – 2014



¹ The forecast, which is periodically compiled and published on the website of the Ministry of Economic Development and Trade of Ukraine by that Ministry with participation of research, international, banking, investment, and other interested institutions.



indicators of country's macroeconomic development).

See folder "Deliverables"

Deliverable: Analysis of the provisions of the draft legislation aimed at amending revenue base of local governments

Timeline: Ongoing process

Result: Performance of an analysis of the Budget Law for the respective year is prepared

Deliverable: Analysis of the Budget Law for the respective year

Timeline: December 2012

The MFSI-II Project experts have analyzed the Main Characteristics of the Law of Ukraine "On the State Budget of Ukraine for the Year 2013." Among other things, this law contains the following characteristics:

- Analysis of the 2013 budget shows some **positive features of the legislative draft and improved transparency of budget formulation**. This, first of all, applies to the fact that the next year will preserve the trends of recent years and the budget law does not introduce any changes to the tax and other laws. Besides, a detailed information used by the Ministry of Finance for calculations of both the State and local budgets is submitted alongside the draft budget.

- The basis for budget calculations is the **Nominal GDP** forecast for 2013 of UAH 1,576bn. This figure is 5.1% higher than the indicator used for the formulation of the 2012 budget, and 10.7% higher than the expected 2012 indicator. Thus, a moderately optimistic scenario is used for setting the key budget indicators, which envisages a beginning of renewal of economy's growth. **The Consumer Price Index** is projected at 4.8%.

- **Based on the projected slowing-down of the economy, it is proposed to more than halve the growth of the minimal social standards.** The growth in minimum wages and subsistence level for employable persons is set at 5.0%. (Increase in minimum wages amounted to 14.0% in 2012, 8.4% in 2011, and 38.1% in 2010².) At the end of the year, the minimum wage will reach UAH 1218 and will exceed the average subsistence level by 3.6% (or UAH 42), as is the case this year. This is a positive fact, even though as mentioned by MFSI-II Project experts earlier, such an excess is not sufficient for ensuring a balance between the labor remuneration fund and social allowances. The experience of European countries shows that the minimum wage level should exceed the subsistence level by at least 2.5 times. However, a greater than budgeted increase in the minimum wage level would only be possible with growth in the productivity of labor. Otherwise, such an increase would only become a driver of inflation.

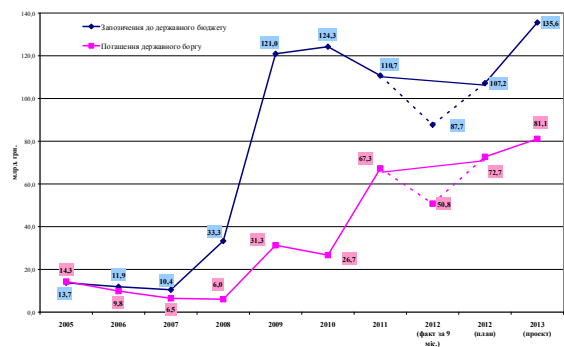
- According to the underlying macroeconomic indicators, the State budget revenues are planned at UAH 362.8bn and expenditures at UAH 412.0bn. Also, the development expenditures are reduced by 42.2% to UAH 40.5bn

² This growth averaged about 20.0% in 2007-2009.



- The **State budget deficit** totals UAH 50.5bn or 3.2% of GDP (vs. 2.6% as planned for this year). This indicator is UAH 11.7bn or **30.1% more than the current year's deficit**. Also, a **positive trend of 2011-2012 towards narrowing the gap between the borrowing amount and debt repayment has reversed towards widening this gap**. It is proposed to increase the borrowing amount by 26.5% to UAH 135.6bn. **This borrowing amount will be the highest in the last eight years.**

Amounts of State Budget Borrowing and State Debt Repayment in 2005-2013



- The share of expenditures for State debt repayment and servicing will increase by 2.3ppt in 2013 compared to this year³, up to 23.0% of all budget expenditures. **Compared to the pre-crisis year 2008 (as well as under comparable conditions), this indicator increased 3.6 times.** In 2014-2016, even without accounting for any borrowing to be undertaken in these years, the State debt repayment and servicing expenditures will increase by 16.7%, 23.9%, and 20.7%, respectively, compared to 2013⁴. This, as well as the allocation of the borrowed funds to satisfy current needs would increase the budget debt burden in subsequent years. In other words, if no urgent action to cut budget spending is taken, to make all the payments under the State debt, either funds would have to be diverted, mainly from the investment expenditures, which are one of the drivers of economic growth, or new borrowing would have to be incurred.

- Unlike this year's situation, the 2013 budget deficit will exceed the planned development expenditures by UAH 10.0bn or by 24.6%. Therefore, **the borrowed funds will be partially used for current needs of the State** in 2013. Let us recall that in the current year, the planned deficit makes up nearly a half of the planned development expenditures, i.e., the borrowed funds are mainly allocated for public investments.

- The draft State budget envisages **the provision of State guarantees** for the total amount of UAH 50.0bn, which is UAH 29.4bn less than planned for this year. The reduction in the total amount could be explained, among other things, by absence of the need to provide guarantees for preparations for the Euro-2012 Championship. However, **it is planned to provide some portion of the guarantees to key spending units for implementing capital expenditures in excess of the budget apportionment.** Such guarantees present a hidden budget deficit and imply a threat of budget's getting out of balance in the medium term. Thus, the essence of the concept of "State guarantee" consists in that the State guarantees repayment of borrower's debt if the borrower is unable to do so on time. Such an instrument of State support is used for the real sector of economy, where a borrower has its own sources of income at the expense of which he could repay the debts. The risk of emergence of the guaranteed event for the State budget needs to be removed as much as possible. In this case, however, the borrowers are government ministries and agencies, which have no income of their own, with the State budget funds being the only source for repayment of such debts. Notably, the authorization to take obligations "in excess of the budget apportionment" means "in excess of the 2013 budget balance."

- Similarly to previous years, the planned **revenues from privatization of State property** could contain the risk of budget shortfall. Let us recall that the plan for this indicator was implemented at 17.2% in 2010, was exceeded by 14.8% thanks to sale of Ukrtelecom in 2011, and was executed at 54.0% for nine months of this year. The amount of UAH 10.9bn is planned for the next year. Therefore, every effort will have to be made for the planned funds to reach the budget.

³ The debt servicing expenditures include expenditures for compensation of the depreciated personal deposits, as envisaged in the 2013 draft budget.

⁴ As per Explanatory Note attachment "The debt and guarantee obligations until full repayment"



- **This is the first budget of Ukraine prepared with a reduction of budget indicators for revenues**, which is a reflection of the slowing-down of economic growth. Thus, the 2013 State budget revenues total UAH 361.2bn (without transfers), which is 5.4% less than the 2012 approved plan.

- A growing fiscal pressure on the economy was noted in recent years, as reflected in increasing the **share of GDP redistribution** via consolidated budget from 30.3% in 2011 to 32.0%⁵ this year. At the same time, a reduction of this indicator to 29.4% is envisaged in 2013, which is 2.6ppt less than the planned revenues of the consolidated budget (with revisions) for 2012. **This reduction could be explained by two factors: a reduction of tax rates, in particular, a reduction of the profit tax rate from 21% to 19%, and down to 5% for software industry entities, as well as the expected underfulfillment of the annual plan this year.**

- The 2013 budget accounts for the reduction in revenues from the **enterprise profit tax** by 3.6% from that expected this year. This is explained by both a reduction of the tax rate as of 1 January 2013, and a transition to the annual payment of the tax, with introduction of the system of mandatory advance payments.

- The growth in revenues from the **value-added tax** is planned at moderate rates (+8.5%), with a simultaneous increase in budget refunds by nearly a quarter (+24.0%). At the same time, the draft provides for increasing such an indicator as VAT on goods made in Ukraine by 5.6% of that planned (with revisions) for 2012. However, it is from this component of the tax that the largest shortfall could be expected this year at the amount of UAH 12.7bn or 13.4% of the plan. Therefore, the actual increase for this item is planned at 18.2% for 2013, which, in the light of the expected GDP (10.3%) and inflation (4.8%) growth rates, appears too optimistic.

- According to the Explanatory Note, the **local budget revenues** in 2013 (without transfers) are planned by the Ministry of Finance at UAH 103.1bn, which is 5.3% more than the plan approved by local councils for 2012. **The personal income tax** continues to retain its position as the largest source of revenues for local budgets. The forecast for revenues from this tax is UAH 69.8bn, which is nearly 10.7% more than the 2012 plan. According to the monthly dynamics of revenues, the expected execution of the personal income tax will amount to about UAH 60.0bn in 2012. Thus, a 16.4% increase of this indicator is planned for 2013 compared to the expected level of this year. In the environment of increase of the nominal GDP by 5.1%, increase in minimal wages by 5.0%, and overall growth of labor remuneration fund by 5.1%, the forecast indicator for the main source of revenues of local budgets for 2013 is overstated by about UAH 6.5bn.

As of 1 January 2013, a new tax payment called the "**tax on immovable property** other than a plot of land" will be introduced. The draft envisages the revenues from its administration at UAH 75.1mn. These funds amount to 0.07% of all local budget revenues (without intergovernmental transfers). Such a minor amount of the planned revenues from this source shows that the enactment of this tax could not be justified by fiscal considerations. Therefore, there is a pressing issue of reconsidering the approaches to taxation of immovable property, as was repeatedly stressed by experts of the MFSI-II Project.

Also, **the Ministry of Finance forecasts a 55.7% growth in local taxes and fees** for 2013. Their total amount is set at UAH 5.3bn vs. UAH 3.4bn planned for 2012. In this case, the single tax is the main source, which has to provide UAH 4.6bn in revenues. The changes made by the Tax Code of Ukraine, which incorporated the proposals made by MFSI-II experts with regard to administration of this tax will make it possible to ensure this level of actual intake of local taxes and fees next year.

- According to the Constitution of Ukraine and the Law "On Local Self-Government," the spending directions and items of local budgets are set by local governments independently. At the same time, according to the presented calculations of the Ministry of Finance of Ukraine prepared for the draft law,

⁵ According to the 2012 annual plan (as amended)

the local budget expenditures of the General Fund and Special Fund (without transfers) will total UAH 218.9bn, which is only 1.4% more than the 2012 plan. When calculating current expenditures of local budgets without taking the social subventions into consideration, a growth of 2.5% is assumed. Taking into account the planned inflation level of 4.8%, local governments will be unable to finance current operation of budgetary institutions even at this year's level and will have to cut their capital expenditures even more. The shortage of funds is estimated at about UAH 3.5bn.

The transfers will total UAH 118.6bn in 2013, which is 4.7% more than the 2012 plan. The Analytical Note to the draft budget mentions a sharp reduction of capital subventions (by 59.6%). In the final version of the law, the amount of capital transfers is increased (at the expense of cutting the funds of the State Regional Development Fund). It now totals UAH 3.9bn, which is 40.7% less than the 2012 plan.

Therefore, a hidden deficit of local budgets pointed out by the MFSI-II experts remains at the level of UAH 10.0bn.

Accomplished (see “Quarterly Report 01 October – 31 December, 2012”)

Result: Analysis of the Changes to the Budget Law for the respective year is prepared and the suggestions to it are incorporated in the Law (in case such changes are brought for consideration of the Verkhovna Rada of Ukraine)

Deliverable: Analysis of the changes to the Budget Law

Timeline: Depending on the date of law adoption.

Deliverable: Analysis of the Changes to the Tax Code, land laws, and other laws related to local budgets, which could affect their revenues and resources prepared

Timeline: Depending on the date of law adoption

Sub-task 1.2.3: Help the GOU develop and review amendments to budget legislation that promote local level strategic planning and enable local governments to attract the private sector resources for the local infrastructure development projects;

- **Help the GOU develop and review amendments to the Budget Code and sub-laws that:**
- **Enable all creditworthy communities to have access to credit resources to fund their infrastructure development projects;**
- **Regulate the process of adoption by local governments of responsibilities and financial obligations within PPP arrangements;**
- **Enable local governments separating energy efficiency savings from the rest of the budget and using these savings to reimburse implementers of performance contracts.**

MFSI-II experts will carry out an analysis of the budget legislation that promote local level strategic planning and enable local governments to attract the private sector resources for the local infrastructure development projects. Based on this analysis, if necessary, IBSER will prepare draft changes to the legislative and regulatory framework, will submit them for roundtable / meeting of NAB discussion, and will develop the strategy for promoting these changes

Result: Development of draft changes to the legislation and regulations

Deliverable: Proposals regarding legislation improvement: draft amendments to the Budget Code (if needed); draft decrees of the Cabinet of Ministers (if needed); draft decisions of the State Treasury (regarding the issues of budget execution when implementing PPP projects) (if needed)

Timeline: April – June 2012

The experts continue developing and reviewing changes to the budget legislation, which would allow local governments attract resources of the private sector for implementation of infrastructure improvement projects.

Striving to assist cities in attracting resources of the private sector for implementation of infrastructure improvement projects, MFSI-II experts conducted three working meetings with the Public Private Partnership Development Program (P3DP) as part of the Memorandum of Cooperation signed by the Institute for Budgetary and Socio-Economic Research and P3DP on 2 October 2012. They also took part in a roundtable to discuss the Draft PPP Development Strategy in Ukraine for 2012-2017 and the Action Plan on 6 November 2012.

Based on the results of these meetings, the experts have identified barriers to PPP development, including:

- lack of monitoring of the consumption of energy resources (electric power, heat, hot and cold water) by individual buildings, which accommodate budgetary institutions, and lack of systems for measurement and verification of the economy of these resources. This primarily prevents from attracting the private initiative to the energy saving activities in the budgetary sphere, where it is envisaged to make payments to the private partner at the expense of the achieved economy in energy costs;
- uncertainty as to the status of obligations undertaken by local governments, which should emerge in the framework of PPP agreements, and, accordingly, lack of the guaranteed performance by the public partner under these obligations in future. This creates a situation, where there is a low level of protection for the private partner and, therefore, its low interest in realization of infrastructure improvement projects;
- absence of practices of reflecting the revenues to relevant budgets in kind, as the result of acceptance by spending units of works and services on the condition of payment for them in subsequent years (commercial credit), and other issues.

In order to remove the said barriers, MFSI-II experts have updated their proposals for amendments to the Budget Code of Ukraine (see previous version of the proposals in the Report for April-June). Thus, the new amendments propose to introduce the concept of State/local contingent debt obligations, provide a comprehensive approach for maintaining the amount of local debt obligations and obligations under local contingent debt at an economically safe level, include the indicator of local contingent obligations in the projected indicative indicators of a local budget when making a local budget forecast for the two budget periods following the planning period etc.

The system for monitoring energy-related expenditures based on the PPB method for selected cities developed under Task 2.1 will also contribute to the removal of barriers to PPP development for implementation of infrastructure projects.

The prepared amendments to the Budget Code of Ukraine have been forwarded to all stakeholders for review.

Accomplished (see “Quarterly Report 01 October – 31 December, 2012”)

MFSI-II experts took part in five working meetings and sessions of a Working Group on legislative regulation of application of such a component of public-private partnership as energy service contracts. The MFSI-II Project experts participated in the said meetings upon invitation from the

Coordinating Center for Implementation of Economic Reforms under the President of Ukraine. This Working Group has been set up to address the issue of legal foundations for operation of energy service companies and implementation of energy service contracts. Representatives from the Ministry of Finance, Ministry of Economy, National Communal Services Regulatory Commission (National Commission), EBRD, and DTEK Company attended these meetings.

The Working Group considered, among other things, a Draft Law on amendments to the Budget Code of Ukraine. This Draft Law is needed to remove legislative barriers for introduction of energy service contracts. As a result, the meeting participants have supported inclusion into the legislative draft the proposals developed by the MFSI-II Project experts. The said proposals are essential for legislative regulation of engaging the private capital in energy saving activities in budgetary institutions. In particular, they deal with maximum protection of energy service companies by guaranteed inclusion into budgets for a long-term perspective of any expenditures required to pay for services under energy service contracts, and, simultaneously, provide protection to cities from unfair practices of energy service companies. At the same time, MFSI-II experts noted that the legislative draft required further significant elaboration (all proposals have been submitted).

The legislative regulation of the said issue would make it possible to attract resources of the private sector for implementation of energy efficiency projects in public sector institutions.

Sub-task 1.2.4: Help local governments assess draft legislation affecting the local development such as Community Associations Bill and Regional Development Bill and suggest amendments with a focus on strengthening local revenues

- IBSEER will review the draft legislation affecting local development and suggest amendments with a focus on strengthening local revenues (if an administrative and territorial reform is implemented, the said proposals will take the aspects of a new State system into consideration);

Deliverable: The proposals based on the analysis findings prepared

Timeline: Ongoing process

Result/ Deliverable:

- IBSEER will review the legislative changes aimed at financial support of regional development, in particular, for establishing a Regional Development Fund, and prepare its proposals intended for strengthening the financial resources of local governments.

Deliverable: The proposals based on the analysis findings prepared (if changes are approved)

Timeline: October – December 2012 and April – June 2013

The Law of Ukraine “On the State Budget of Ukraine for the Year 2013” provides for establishment of the Regional Development Fund as follows:

- UAH 987.5mn will be allocated for financing of programs and projects of socioeconomic development of the regions;
- UAH 300.0mn will be allocated for servicing and repayment of debt obligations for the credits obtained under State guarantees, which are used for realization of tasks and activities of the State Regional Development Fund.

However, according to provisions of the Budget Code of Ukraine, not less than 1 percent of the projected amount of revenues of the General Fund of the draft State budget of Ukraine for the relevant budget period must be allocated for accumulation into the Regional Development Fund. Based on this, the 2013 Regional Development Fund should have amounted to more than UAH 3bn. The actual amount provided in the budget is less than UAH 1.3bn.



On 20 March 2013, the Cabinet of Ministers of Ukraine issued Ordinance No. 149-r “Certain Issues of Utilization of State Capital Expenditures in 2013.” This Ordinance directs to distribute UAH 1.7bn in State budget funds between the government ministries and state agencies, Council of Ministers of the Autonomous republic of Crimea, oblast, and Sevastopol City State administrations. The Law "On the State Budget of Ukraine for the Year 2013" had allocated those funds as a lump sum to the Ministry of Finance of Ukraine under the budget program “State capital expenditures distributed by the Cabinet of Ministers of Ukraine.”

Making such an allocation in the middle of budget execution is not contrary to the budget law. Thus, according to the Budget Code of Ukraine (Article 23 Part 6), transfer of budget appropriations from one key spending unit to another one for the performance of the same functions or services is to be carried out by resolution of the Cabinet of Ministers of Ukraine coordinated with the Verkhovna Rada Committee on Budget.

The funds have been allocated as follows: UAH 1,285.7mn to the government ministries and other State agencies; and UAH 415.4mn to the Council of Ministers of the Autonomous Republic of Crimea, oblast and Sevastopol City State administrations (see Figs. 1, 2, and 3).

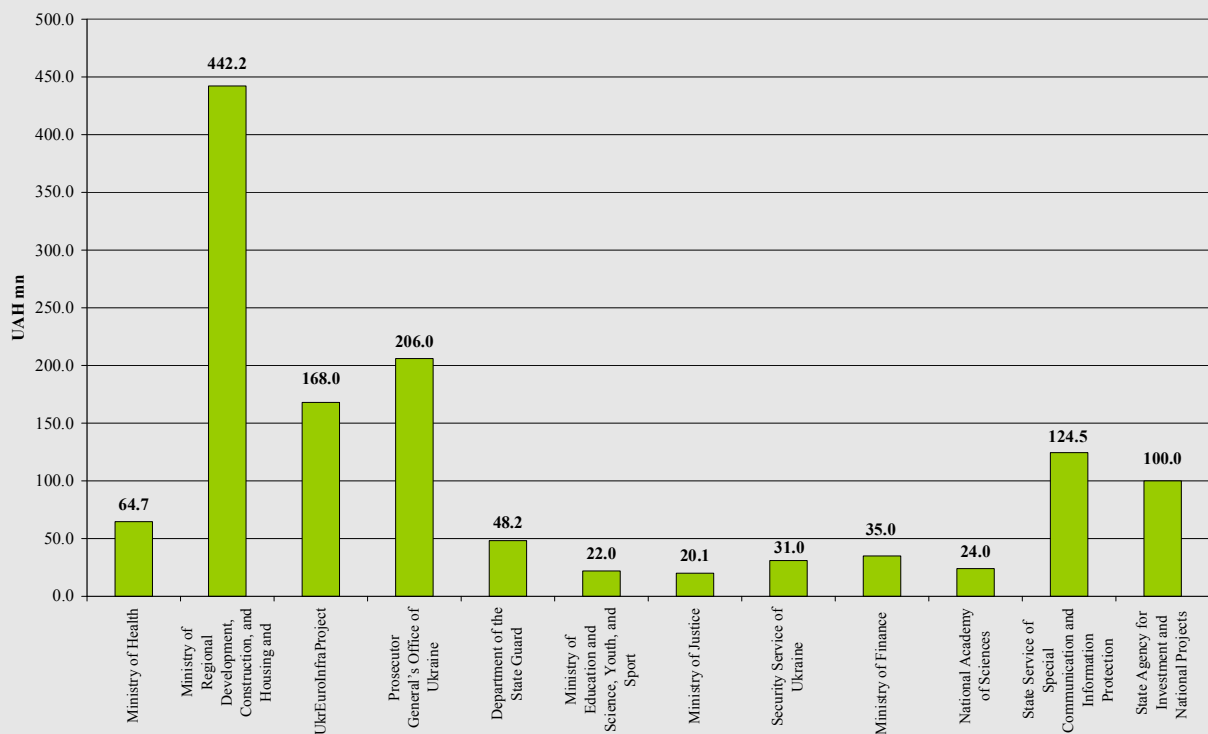


Fig. 1. Allocation of Funds Intended for Government Ministries and Other State Agencies (by recipient of the funds)

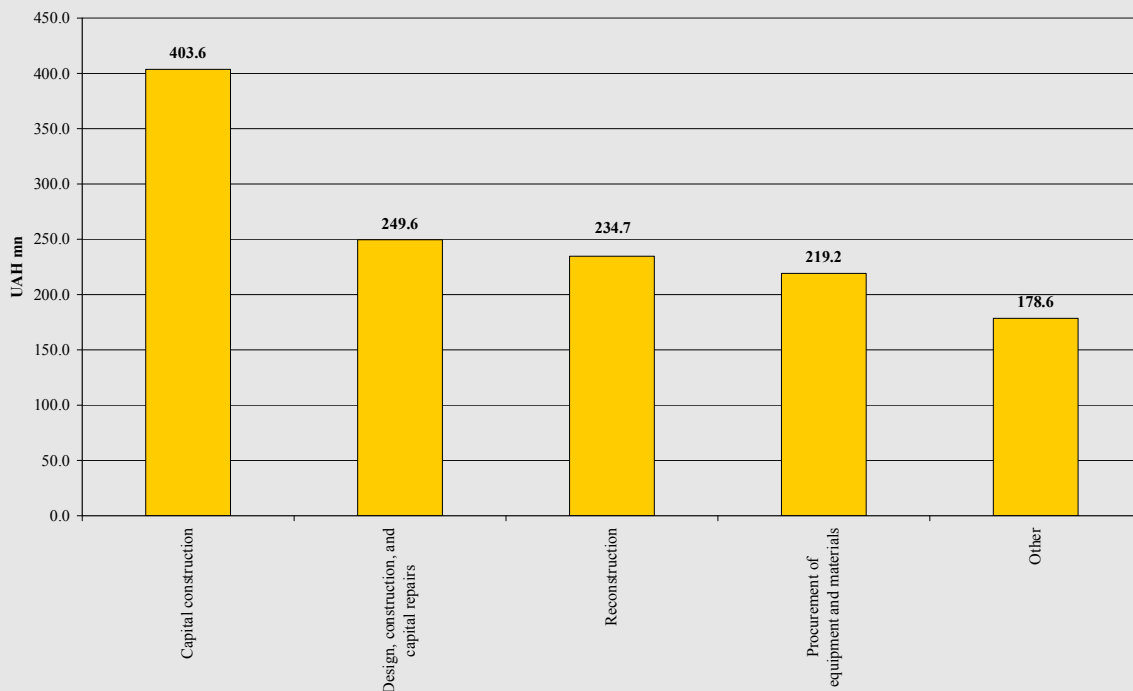


Fig. 2. Allocation of Funds Intended for Government Ministries and Other State Agencies (by funds use)

Such an approach to allocation of capital expenditures, however, reduced the budget transparency, as was stressed by the MFSI-II experts in their analysis of the 2013 State Budget Law of Ukraine, as the Verkhovna Rada does not consider either the directions or criteria of using funds when approving such expenditures. It also prevents access of a wider public to this information, since it is only experts who could find and analyze such documents. Thus, the said ordinance contains an investment-specific allocation of funds intended for government ministries and other State agencies. However, the criteria for selection of the specific investments to be funded are not transparent and do not allow tracking the expediency of allocation of funds. For example, the Ministry of Regional Development, Construction, and Housing and Communal Services of Ukraine has been granted UAH 100.0mn for construction of priority investments in the Donetsk oblast.

Besides, only the directions of using these funds and general amounts of the financial resources allocated for each region are indicated for the Council of Ministers of the Autonomous Republic of Crimea, Oblast, and Sevastopol City State administrations. It is also envisaged that the allocation of the funds by individual investments shall be implemented by the Council of Ministers of the Autonomous Republic of Crimea and the respective State administrations. This would lead to an even greater dependence of local governments (city, village, and settlement budgets) on decisions of their oblast State administrations.

The regional allocation also points to a non-transparent and disproportionate distribution of the financial resources directed from the budget for capital expenditures (see Fig.3).

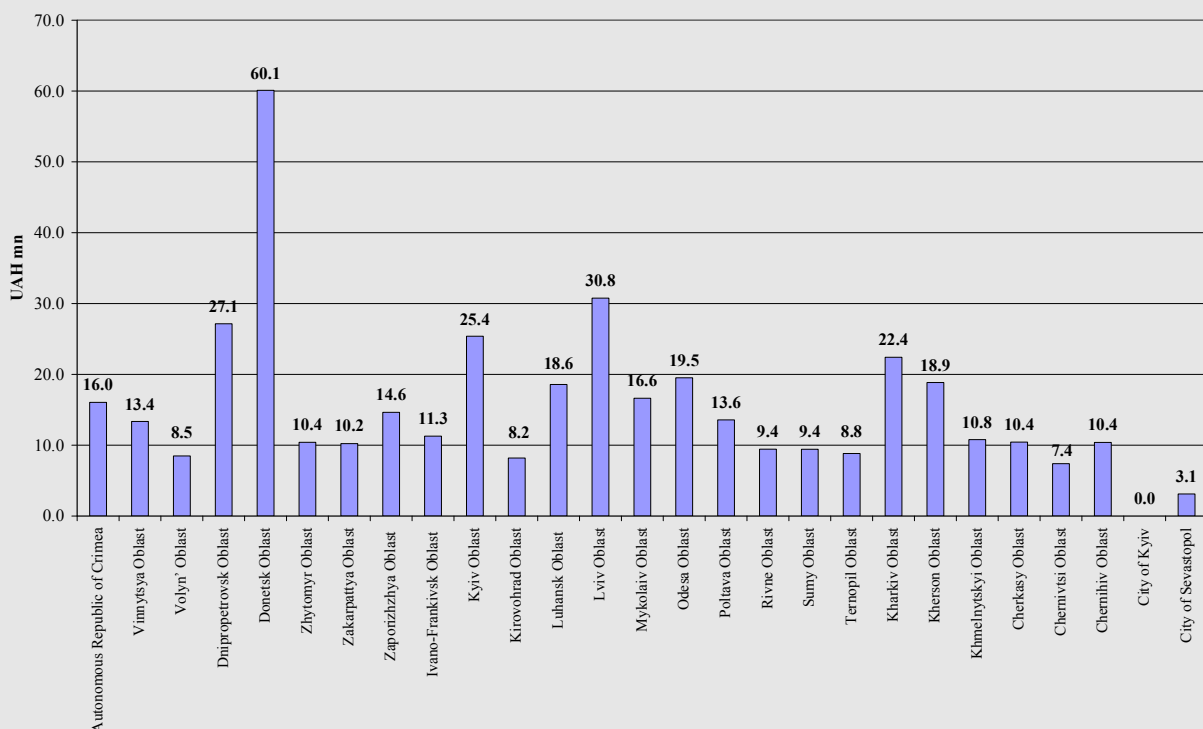


Fig. 3. Allocation of Funds Intended for the Council of Ministers of the Autonomous Republic of Crimea, Oblast and Sevastopol City State Administrations

As was repeatedly noted by MFSI-II experts, it is necessary to move away from such allocation mechanisms, since they contradict to the ideology of Performance Program Budgeting and standards of budget information accessibility. When determining the amounts of capital expenditures, it is advisable to use a clear and transparent formula-based approach.

Accomplished (see “Quarterly Report 01 October – 31 December, 2012”)

The Resolution of the Cabinet of Ministers of Ukraine No. 30 of 23 January 2013 amended the Procedure for preparation, evaluation, and selection of the investment programs/projects, which can be implemented at the expense of resources of the State Regional Development Fund.

Among other things, the minimal cost of the investment programs to be implemented in oblast-significant cities was reduced to UAH 1mn (previously, this cost had to be UAH 5mn at a minimum). In addition, the minimal cost of the investment programs intended to address the problems of one or more territorial communities (district-significant cities, villages, settlements) was reduced from UAH 1mn to UAH 0.2mn.

These changes will make possible to implement small investment projects and programs of local significance at the expense of resources of the State Regional Development Fund.

Accomplished (see “Quarterly Report 01 January – 31 March, 2013”)

Sub-objective A.1: Ensure institutional sustainability of the PPB training program(s).

Sub-task A.1.1: Conduct a study of the training centers that can offer PPB training sessions and methodological support to facilitate the introduction and effective application of PPB at the local level; identify those centers that are capable and interested in conducting PPB training sessions and providing methodological support on a regular basis

- Based on the strategy to establish a sustainable PPB training program(s) in Ukraine developed in the first year of project implementation, IBSER will organize and select one or two post-graduate educational institutions, which are capable of and interested in delivering PPB training sessions. With IBSER's support, these organization(s) will develop and adopt the PPB training curriculum and materials and will conduct PPB training sessions to support the introduction of PPB at the local level. During phase one, MFSI-II experts will organize and deliver PPB trainings for specialists of this/these organization(s).

Deliverable: Report on the number of trainings held and the number of participants attending the trainings with a breakdown by gender

Timeline: October 2012 – March 2013

In order to implement the task, the MFSI-II Project experts addressed a letter in the reporting period to the President of the Academy of Financial Management under the Ministry of Finance of Ukraine T.I. Yefymenok asking to consider a possibility of setting up a system of retraining and training for public servants at the Academy of Financial Management. No reply was received in the reporting period.

Also, the MFSI-II Project experts sent a letter to the Ministry of Finance of Ukraine asking to set up a working meeting to discuss the ways for launching a process of retraining and raising qualifications of public servants on the issues of PPB-based formulation and execution of local budgets.

Accomplished (see “Quarterly Report 01 October – 31 December, 2012”)

Sub-task A.1.2: Help those training centers to develop a PPB training curriculum and PPB training materials and to conduct at least 50 PPB training sessions for relevant GOU officials

- IBSER will hand over the PPB Handbook developed under Sub-task 1.1.4 to the selected training centers and will assist with the PPB training curriculum, as well as conduct at least 50 PPB training sessions with the specialists of such training centers. During the second year of project implementation, MFSI-II experts will deliver at least 10 PPB training sessions with the specialists of such training centers.

Deliverable: Report on the number of trainings held and the number of participants attending the trainings with a breakdown by gender

Timeline: April – June 2013

IBSER consultants conducted training for local specialists at the Center for Upgrading the Qualifications of Executive Cadre at the Odesa Regional Institute of Public Administration of the National Academy of Public Administration under the President of Ukraine (ORIDU NADU under the President of Ukraine). There were four trainings delivered in the period of 11 - 16 March 2013.

The trainings were attended by the local government officials from the Autonomous Republic of Crimea, Vinnytsya, Mykolaiv, Odesa, and Kherson oblasts, and the city of Sevastopol (14 men and 10 women).

Accomplished (see “Quarterly Report 01 January – 31 March, 2013”)



Within the reporting period, a Memorandum of Cooperation was signed with the Center for Retraining and Qualifications Improvement of the Staff of Public Authorities, Local Governments, State Enterprises, Institutions, and Organizations of the Kivorohrad Oblast State Administration public educational institution. The common objective of the parties is collaboration in providing training on implementation of the PPB methodology at the local level.

On 6 June 2013, MFSI-II experts held a conference with the Center representatives, which set out the priority activities and agreed on the terms of training schedule for the specialists who will teach the methodological principles of PPB to the staff of public authorities and local governments of the Kirovohrad oblast.

This would allow developing of the practical experience of conducting the PPB trainings, which will subsequently help the local government staff to obtain the required knowledge and skills for effective implementation of PPB at the local level.

MFSI-II consultants continues training sessions for local specialists at the Center of Qualifications Improvement for the Management Cadre of the Odesa Regional Institute of Public Administration of the National Academy of Public Administration under the President of Ukraine (ORIDU NADU under the President of Ukraine). Training was delivered on 14 and 29 June 2013.

The delivered trainings were attended by 53 local government officials from the Autonomous Republic of Crimea, Vinnytsya, Kirovohrad, Ivano-Frankivsk, Sumy, Dnipropetrovsk, Cherkasy, Khmelnytskyi, Mykolaiv, Odesa, Luhansk, Kherson, and Zaporizhzhya oblasts, and the city of Sevastopol (including 25 men and 28 women).

See folder “Deliverables”

Objective B: Develop and introduce financial practices that foster energy efficiency in 15 selected cities

Task 2.1: Assist the cities in introducing an effective system of managing energy savings in the public sector

- IBSEER will improve the unified methodology developed during the first year of project implementation and will select four Ukrainian cities for the second year of the project. IBSEER will coordinate selection with MHR, Public Private Partnership Development Program and Developing Initiative for Advocating Local Governance in Ukraine (DIALOGUE).
- To assist the cities in developing well-founded energy efficiency programs, IBSEER will develop a system of monitoring of energy expenditures based on PPB method for the selected four cities, which will be based on similar system developed for the cities selected for the first year of the project. In order to implement this system and based on the experience of MFSI-II Project accumulated in the first year of implementation, IBSEER will prepare the training materials on implementation of the said system and will conduct training for specialists of key spending units in the four cities selected for its application.

Result: *Analysis of four selected cities current budget expenditures on energy resources.*

Deliverable: *Report on analysis of four selected cities current budget expenditures on energy resources.*

Timeline: *January – March 2013*



Continued collaboration with the Year One project cities.

Thanks to collaboration of MFSI-II experts with the Year One project cities, two more cities, Lviv and Horlivka, received NEFCO credits for implementation of their energy saving projects in the reporting period.

The Joint Energy Saving Program in the City of Lviv project will be implemented in Lviv. The project intends to upgrade the street lighting and renovate municipal buildings. It is planned to install LED lighting fixtures, replace window panes, improve thermal insulation of pipelines, provide heat insulation to roofs and walls, modernize the heating systems of buildings, and set up a new heat point. It is expected that implementation of this project would allow to save 1113MWh of electric power per year and cut the CO₂ emissions by 512.8 tons and SO₂ emission by 30.8 tons per year.

The city of Horlivka will realize the Modernization of Street Lighting in the City of Horlivka project. This project involves replacement of 1100 incandescent lamps currently used for street lighting in the city with high-pressure sodium lamps. Such lamps combine a higher luminosity with a lower energy consumption. It is expected that implementation of this project would save 544MWh of electric power per year and reduce CO₂ emissions by 436 tons per year.



Another achievement of MFSI-II experts in cooperation with the cities in the reporting period involved getting an approval by the city of Zhytomyr of its municipal guarantee for the Development of the Zhytomyr City Heating System project under a new procedure. This new guarantee approval procedure requires approvals not just by the Ministry of Finance, but also by the Cabinet of Ministers of Ukraine.

The new Zhytomyr city project is designed to increase the operational reliability of the municipal Zhytomyrteplokomunenergo heating utility, reduce energy consumption, and improve the quality of provided heating and hot water supply services to city residents by developing the Zhytomyr municipal heating system. Implementation of the project will have a significant social and economic impact for the city, including the estimated:

- reduction of natural gas consumption by 8 million cu m per year;
- reduction of electric power bills by UAH 12.0mn per year;
- reduction of operating costs (repair and maintenance) by UAH 3.0mn per year.

The total economic effect after implementation of the project will amount to UAH 31.9mn per year, and the city residents will benefit from stable and reliable heating service.

The city of Zhytomyr sent thank you letter for the methodological and advisory assistance provided by MFSI-II experts.

Accomplished (see “Quarterly Report 01 October – 31 December, 2012”)

MFSI-II experts have analyzed the energy expenditures of municipal budgets in 2008-2011 and noted that the expenditures for heating, electricity, and natural gas were growing every year.

Heating costs account for the largest share in the overall structure of energy expenditures of the cities of Alchevsk, Myrhorod, Lutsk, Vinnytsya, and Ternopil.

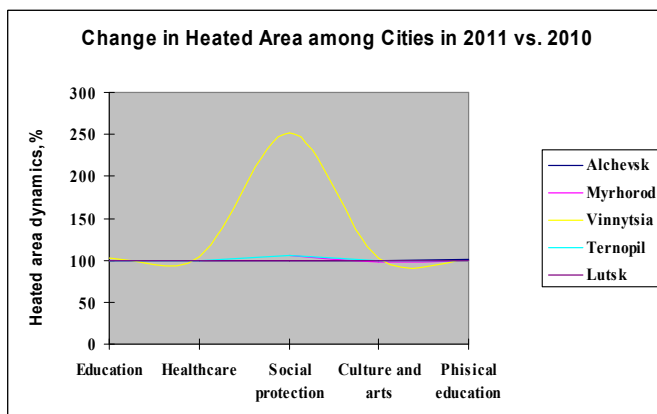
The department of education accounts for the largest percentage in expenditures for communal services and energy for all cities, immediately followed by the public health sector.

Variations in terms of heat consumption per 1,000m² of heated area are observed between the cities. This could be due to presence of buildings with low heat resistance due to old age and lack of major repairs.

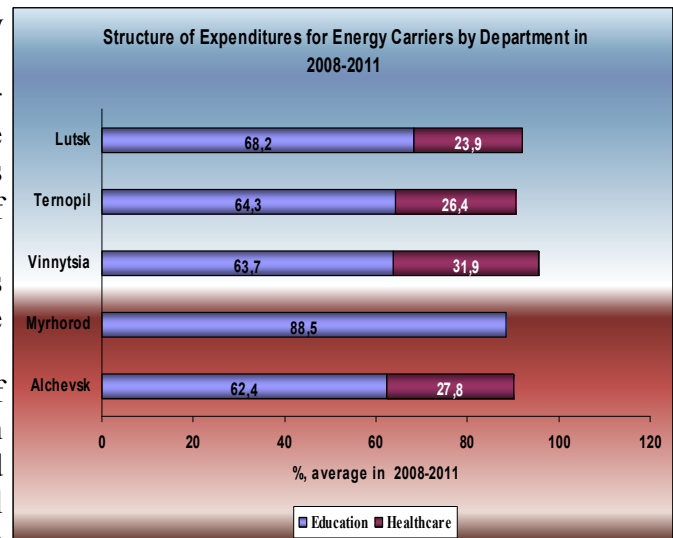
The analysis of energy expenditures shows significant variations in the ratio of heated area to the number of persons served by institutions.

The analysis of dynamics of the heated area of budgetary institutions in the cities in general in 2010-2011 shows that it largely remained unchanged, while the expenditures for communal services and electricity increased. This confirms the fact that increased energy expenditures are not linked to increases in the heated area, but mainly to the

Change in heated area among cities on 2011 vs. 2010



Structure of expenditures for Energy Carriers by Department in 2008-2011



increased cost of respective services.

The analysis of heat consumption per one square meter of heated area by budgetary institutions in 2011 shows that heat consumption differed for each city (in particular, the indicators varied depending on the population size, size of network of budgetary institutions etc.).

Heating accounts for the largest percentage in the general structure of energy expenditures of Alchevsk and Ternopil (45.1% to 45.7% in Alchevsk, and 70.9% to 76.3% in Ternopil in 2008-2011). Electricity is the second largest expenditure item, with its average share of 11.7% and 13.9% in the last four years for Alchevsk and Ternopil, respectively.

In the overall structure of energy expenditures of Vinnytsia and Lutsk, heating also accounts for the largest share (75.6% to 78.1% in Vinnytsia, and 67.7% to 77.7% in Lutsk during 2008-2011). Electricity expenditures present the second largest item (similarly to the previous cities), with their share amounting to 12.7% for Vinnytsia and 13.6% for Lutsk on average within the last four years.

As regards to Myrhorod, it also follows the trend of the previous cities. Heating accounts for the largest share in the city's energy expenditures (from 63.9% in 2008 to 70.1% in 2011), electricity costs being the second largest, and their share in the overall structure of energy expenditures amounted to 11.4% on average in the past four years.

The common recommendations for the project cities (Alchevsk, Lutsk, Vinnytsia, Ternopil, and Myrhorod):

1. When monitoring and evaluating city's energy expenditures, one should compare indicators under comparable conditions, e.g., in comparable prices with regard to expenditures.
2. When finalizing the system of monitoring and evaluation of city's energy expenditures, provision should be made for tracking the condition of premises, in particular, their energy performance.
3. Certain standards need to be applied with regard to the ratio of heated area to the number of persons served by institutions (or to the number of full-time staff for the institutions, which provide



administrative services). Analysis of such indicators in the course of monitoring and evaluation will make it possible to analyze the efficiency of use of the premises accommodating the budgetary institutions.

4. The interrelation between the decrease/increase in the volume of consumption of communal services and energy and the energy saving activities, worsening condition of the premises, weather conditions etc. should be provided with a documented justification.

Accomplished (see “Quarterly Report 01 January – 31 March, 2013”)

Result/Deliverable: Four Ukrainian cities for the second year of the project are selected using the developed unified methodology

Timeline: October – December 2012

The selection of cities for participation in the second year of the MFSI-II Project has been conducted according to an improved version of the selection methodology developed in the first year of the Project.

Based on the competition results, the cities of Ternopil, Vinnytsya, Myrhorod, Alchevsk, and Lutsk have been selected and the Memoranda of Cooperation have been concluded with these cities.

The issues of energy efficiency and energy saving are appropriately reflected in the policies of respective city councils of the selected cities. For example:

- a municipal energy saving program for 2012-2015 approved in Myrhorod;
- energy efficiency and energy saving programs for 2010-2020 are being implemented in Vinnytsya and Ternopil, and Vinnytsya also has a municipal energy plan;
- in addition to its energy efficiency program approved for 2011-2015, the city of Alchevsk has a concept of sustainable energy development policy;
- in Lutsk, in addition to implementation of its municipal energy plan, a sustainable energy development plan until the year 2020 is being developed.

The cities must not only strive to improve their energy efficiency, but should also undertake practical energy saving activities/projects. Therefore, the existence of such projects was one of the criteria in the city selection. All the chosen cities meet this criterion, for example:

- the project “Improving the energy efficiency of Ternopil city social facilities through development and implementation of a long-term mechanism of renewable financing of capital investments in modernization of buildings and essential infrastructure systems of budgetary institutions of the Ternopil City Council” (Ternopil);
- the project “Reconstruction of Myrhorod city heating system with utilization of alternative sources of energy in 2008-2013” (Myrhorod), and others.

Collaboration of the cities with the MFSI-II Project will help the cities to improve their energy efficiency, will facilitate establishment of an effective energy saving system in each of the selected cities, in particular, through experts’ development of a system for monitoring of energy expenditures for the cities, and financial incentives for energy saving in the budgetary sphere. The participation of city representatives in the seminars, working meetings, and other events organized by the MFSI-II Project will create opportunities for experience-sharing and for learning from the best domestic and international practices of improving the energy efficiency at the local level.

In the reporting period, the selected cities were actively collaborating with the MFSI-II experts. The cities are providing detailed information about their budgets with regard to expenditures for communal services and energy, and their consumption in the last four years, and information required for assessing the cities’ capacity to attract funds for implementation of energy saving projects.

Based on the results of analyzing the said information, the MFSI-II experts prepared their assessments of the creditworthiness of the cities of Myrhorod, Lutsk, Ternopil, Vinnytsya, Alchevsk and made the relevant conclusions. Creditworthiness conclusions contain, among other things, a review of the



sources of revenues of municipal development budgets, structure of expenditures, which reflects municipality's ability to allocate resources for the development needs etc. When conducting these analyses, the MFSI-II experts noted a growth in the development budget revenues of Lutsk, Myrhorod, and Ternopil in the last three years, and improvement in the level of its execution. Another positive factor consisted in a timely repayment of short-term loans by all the cities, whose creditworthiness was evaluated.

The general conclusion to be drawn from the conducted assessment of creditworthiness of the cities is that the development budgets of Lutsk, Myrhorod, Ternopil, Alchevsk and Vinnytsya are sufficient for annual repayment of local debt or for performance of guarantee obligations in case of a guaranteed event within the amounts required for implementation of their planned energy saving projects.

Experts of the MFSI-II Project carry out analysis of the cities selected for participation in the second year of the Project in terms of their current budget expenditures on energy resources.

Accomplished (see "Quarterly Report 01 October – 31 December, 2012")

Result/Deliverable: System for monitoring energy-related budget expenditures for the four selected cities.

Timeline: April – June 2013

MFSI-II experts updated the system for monitoring energy-related budget expenditures for the five selected cities: Lutsk, Alchevsk, Ternopil, Myrhorod and Vinnytsya. The new system has been brought in conformity with the latest changes in the Ukrainian budget legislation.

The system now contains a new section related to application of a temperature regime coefficient. The presentation of specific formulae to determine this coefficient will simplify the system's use. Also, the system has been streamlined by reducing the number of indicators it contains.

The system is based on the principles of completeness, unification, and formalization of documents and periodicity. Thus, completeness of information will ensure that system for monitoring energy-related budget expenditures is used by all budgetary institutions within an individual city. Unification and formalization of the documents and indicators used for monitoring and evaluation will provide for equivalence and comparability of information. Strict periodicity of generating the information on energy consumption by budgetary institutions would allow making annual evaluations.

The efficiency of budget expenditures within MES is evaluated according to the scale of High, Medium, and Low. The evaluation results will show:

1) the level of efficiency of budget expenditures under a budget program for utilities and energy based on operational results of such budgetary institution in the reporting year, in particular:

➤ **Indices, which describe the volume and cost of consumed energy resources.**

The indicators will show:

the index, which characterizes the volume of consumption of utilities and energy. It is calculated as a ratio of the change in floor area to the change in the volume of energy consumption;

the index, which characterizes the cost of utilities and energy consumed. It is calculated as a ratio of the above-mentioned index to the change in expenditures for utilities and energy per unit of floor area.

The examples of index calculation results are shown in Fig. 1 and Fig. 2 below.

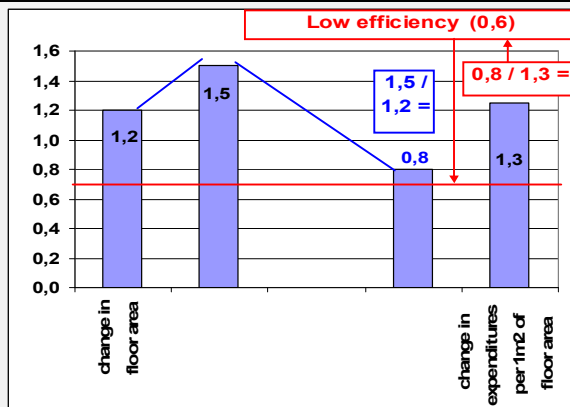


Fig. 1. Example of low efficiency of expenditures by the indices, which describe the volume and cost of energy consumption.

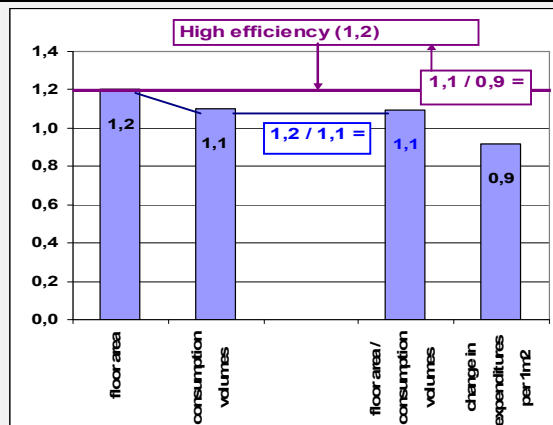


Fig. 2. Example of high efficiency of expenditures by indices, which characterize the volume and cost of consumed energy resources.

➤ **Index characterizing the end user costs.**

This index reflects the dependence of change in expenditures per unit of the contingent (persons served by institutions) of a budgetary institution (in comparable prices) on the change in the floor area. The examples of results from index calculation are shown in Fig. 3 and Fig. 4.

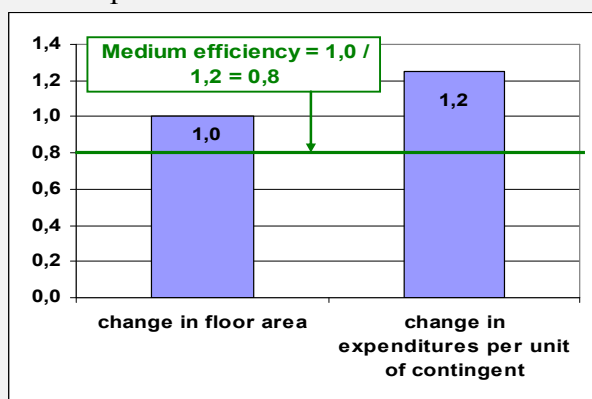


Fig. 3. Example of medium efficiency of expenditures by the index characterizing the end user costs.

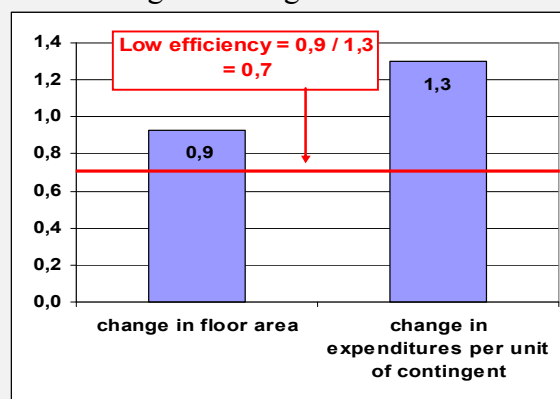


Fig. 4. Example of low efficiency of expenditures by the index characterizing the end user costs.

➤ **Index characterizing the level of improved efficiency of budget expenditures after implementation of energy saving activities (projects) in the year preceding the reporting year.**

This index will show the ratio of energy expenditures before implementation of energy saving activities to the amount of such expenditures after completion of those activities.

To determine the total efficiency index all the abovementioned indices shall be multiplied by each other.

2) the level of use of utilities and energy under a budget program compared to their average use in the budgetary sphere. The evaluation will be carried out based on the level of use of utilities and energy under the budget program per unit of floor area.

3) the efficiency of funds invested in implementation of energy saving activities (projects). The evaluation will reflect savings on the investment in implementation of energy saving activities (projects). The examples of the results of such evaluation are shown in Fig. 5.



Group #	Indicator description	Indicator
1	expenditures for energy per unit of floor area under budget program, UAH	0,5
2	expenditures of energy saving activity per unit of floor area under budget program, UAH	500,0
3	Ratio, times (= 1 / 2)	0,001
4	expenditures for energy per unit of floor area in budgetary sphere, UAH	1,5
5	expenditures of energy saving activity per unit of floor area in budgetary sphere, UAH	800,0
6	Ratio, times (= 4 / 5)	0,002
7	Efficiency (Low) (= 3 / 6)	0,5

Fig. 5. Example of low efficiency of funds invested in implementation of energy saving activities (projects).

The evaluation results can be displayed according to the format below.

**Evaluation of Efficiency of Utilities and Energy Expenditures
(Example of Table Generation)**

Name of budget program (code of provisional classification of expenditures and crediting of local budget it belongs to)	Indicator description	I. General indicators (for budgetary sphere institutions in general)	II. Individual indicators (by specific group of similar budgetary sphere institutions)							
			Education							
			On average in education department(1000)	Preschool education (1010)	Provision of general secondary education by general secondary educational institutions(1020)	Provision of general secondary education by general educational boarding schools and general educational health center boarding schools (1040)	Provision of extracurricular education by extracurricular educational institutions, extracurricular activities with children (1100)	Centralized accounting (1190)	...	
2		4	5	6	7	8	9	10	11	
Evaluation by budget program in general based on results of budgetary institution performance in the reporting year										
	expenditures for heating									
	expenditures for electric energy									
	expenditures for natural gas									
	expenditures for water supply and sewerage									
Evaluation by level of use of utilities and energy by budget program per unit of floor area										
	heat consumption									
	electric energy consumption									
	natural gas consumption									
	water supply and sewerage services consumption									
Evaluation of returns on investment in implementation of energy saving activities (project)										
	expenditures for heating									
	expenditures for electric energy									
	expenditures for natural gas									
	expenditures for water supply and sewerage									
Evaluation of efficiency of budget funds use										
	expenditures for heating									
	expenditures for electric energy									
	expenditures for natural gas									
	expenditures for water supply and sewerage									

Summary indicators of efficiency evaluation of budget funds used by budget programs in general for a number of years (e.g., five years) according to the format below will be used as a management document.



**Sample Summary Evaluation of Efficiency of Budget Expenditures
for Utilities and Energy by Year**

Provisional program classificatio n of local budget expenditur es	Indicator description Name of budget program	Evaluation of efficiency of budget funds use (Ip)					Expenditures for heating (Ipa)				
		2010	2011	2012	2013	2014 (plan)	2010	2011	2012	2013	2014 (plan)
1	2	4	5	6	7	8	4	5	6	7	8
I.	General indicators (for budgetary sphere institutions in general)	H	H	M	L	L	H	M	M	L	L
1000	Average for education department	M	M	M	L	L	M	M	M	L	L
1010	Preschool education	H	H	M	L	L	M	M	M	L	L

Introduction of a system for monitoring energy-related budget expenditures would allow the MFSI-II Project cities to:

- identify the budgetary sphere facilities, which need implementing energy saving activities the most;
- analyze efficiency of already implemented energy saving activities/projects;
- make appropriate management decisions with regard to adjusting the existing or introducing new energy saving activities/projects;
- determine the amount of funds saved, which will accrue as the result of implementation of energy saving activities/ projects.

All these would promote a more efficient use of budget funds and an improved local capacity in creating strong energy efficiency system.

See folder "Deliverables"

Result/Deliverable: The training course developed and a report prepared on the number of trainings held and the number of specialists who participated in trainings with a breakdown by gender.

Timeline: July – September 2013

Task 2.2: Assist in designing and implementing financial incentives to promote the establishment of effective energy savings systems in the public sector

- IBSER experts will help municipalities design and introduce financial incentives to promote the establishment of effective energy savings system in the public sector.
- If needed, a review and improvement of the budget legislation needed for implementation of the said financial incentives will be carried out under Task 1.2.3.
- To help the chosen municipalities introduce the financial incentives that foster energy efficiency, IBSER will provide advisory support to the municipalities in designing budget programs, in particular, those intended for the realization of individual investment projects.

Result/Deliverable: Recommendations on financial incentives to promote the establishment of an effective energy savings system in the public sector are designed and presented at a session of the Financial and Economic Forum.

Timeline: October 2012 – March 2013

MFSI-II experts have updated the Recommendations on financial incentives to promote the establishment of an effective energy savings system in the public sector.

In particular, they have chosen a method for calculation of savings in payments for communal services and energy. These savings will be used for financial incentives in the budget period. The experts

have suggested to use the balance of funds at the beginning of the budget period following the period, when the savings were generated, as a source for implementing the incentive activities. To this end, key spending units of local budgets will have to submit to Finance Directorates their calculations as to the savings in communal services and energy carriers achieved in the reporting year. Local governments will be amending their local budget resolutions to accumulate the saved funds under a separate budget program. After conducting a competition and selecting the spending units to receive incentives, these accumulated funds will be distributed among them to provide financial incentives to the staff of respective institutions and materiel and equipment to the institutions, and implement energy saving activities. The balance of the funds could be spent for other energy saving activities.

A systemic approach is essential to address the issue of using the savings in payments for communal services and energy carriers. Therefore, these recommendations are an integral part of the general mechanism for using the saved funds.

Such a mechanism provides for accounting the saved funds generated through implementation of energy performance projects. This is due to the fact that it is necessary to ensure:

- targeted use of the saved funds for repayment of debt, where debt was incurred for project implementation, or for compensating an ESCO;
- an increased amount of expenditures for energy saving activities.

When working with the project cities, MFSI-II experts will be suggesting for each local council to address certain additional issues, including:

- whether incentives should be provided to all institutions, which have achieved certain savings in communal services and energy, or just those, which have reached sufficiently high savings amounts?
- would sanctions be used against the spending units, which have allowed unjustified excessive consumption of communal services and energy above the set limits?
- whether incentives should be provided to officials and staff of the institutions, which have implemented energy saving activities, but achieved the savings figures higher than those planned in the design documents?

To implement the above-mentioned and other issues MFSI-II experts will be providing recommendations with regard to the respective provisions to be included in the said mechanism, depending on the wishes of individual cities.

The Recommendations will be presented at the 11th Forum.

Accomplished (see “Quarterly Report 01 January – 31 March, 2013”)

Recommendation have been presented on **5 April 2013** at the 11th Forum “Energy Efficiency of Budget Expenditures as a Road to Economic Prosperity”. When discussing the proposed methodological principles of financial incentives, the participants noted that introduction of such a transparent mechanism needs to be ensured for the accumulation of funds from the utility and energy-related savings and their spending, online monitoring of energy consumption etc. In general, the participants supported a comprehensive approach to financial incentives for promoting reduced energy consumption in the public sector. Such an approach will resolve several important issues: (1) incentives to reduce energy consumption; (2) targeted use of the saved funds, where either funds or energy service companies were engaged in implementation of the project; and (3) increased spending for energy saving activities.

See folder “Deliverables”

Deliverable: Consultations on system implementation provided to the cities, including for development of budget programs and individual investment projects.

Timeline: April – September 2013



MFSI-II will provide advisory support to the municipalities in designing budget programs, in particular, those intended for the realization of individual investment projects.

Collaboration with the City of Ivano-Frankivsk Continues.

Experts of the MFSI-II Project have assisted the city of Ivano-Frankivsk to obtain an approval from the Ministry of Finance to borrow from an International Financial Organization. The borrowed funds will be used for completion of the project Improving the Energy Efficiency in Buildings of Educational Institutions of the City of Ivano-Frankivsk. The project aims to reduce the level of heat energy consumption in six educational institutions thus ensuring adequate temperature for children's staying in these institutions. A successful implementation of this project has an important socio-economic significance and plays a leading role in the system of energy conservation of the city of Ivano-Frankivsk. The environmental benefits of the project include a reduction of CO₂ emissions by 415.7 tonnes/year and savings of heat energy by 2,057,988 kWh/year.



Collaboration with the City of Vinnytsya.



The city of Vinnytsya was the second city in Ukraine to have successfully passed through the procedure of its local guarantee approval by the Cabinet of Ministers of Ukraine for the city's energy performance project. The city has achieved such a positive result thanks to cooperation with experts of the MFSI-II Project. For instance, the MFSI-II experts provided methodological and advisory support to the city in drafting the required resolutions of the City Council and amending the municipal budget.

As part of the energy performance project, the Municipal Diagnostic Center will be connected to a more efficient and modernized boiler house. This would provide the required level of temperature comfort for patients of this Center. Also, the project envisages installation of 11 new heating points in city's buildings, replacement of 1,594 m of heat networks, and other modernization activities. When completed, the project will cut consumption of natural gas by 426,000m³, reduce CO₂ emissions by 818 tonnes/year, and save municipal funds for heating service.

Collaboration with the City of Myrhorod.

MFSI-II experts helped the city of Myrhorod to get a borrowing approval from the Ministry of Finance for implementation of the Improving the Energy Efficiency in the Buildings of Educational Institutions in Myrhorod project.

The main objective of this project is to reduce consumption of energy by educational institutions in Myrhorod through introduction of energy efficient technology and equipment. Implementation of the project will improve temperature control in the educational institutions, which will contribute to improved pupils' health, completeness and quality of education.



Implemented project will have such environmental benefits as 32,693kWh/year lower electric power consumption and 105.8 tonnes/year reduced CO₂ emission.

The Myrhorod Mayor sent a letter on 8 July 2013 to thank the MFSI-II experts for their support. In his letter the Mayor stressed that implementation of the project would have a significant impact on the living standards in the city.

See folder "Deliverables"

Task 2.3: Assist partner municipalities in building capacity of municipal enterprises to conduct modern financial analysis and planning to support their strategic and annual plans

- IBSEER experts will assist partner municipalities to build capacity of communal utilities in financial and economic analysis and planning as part of their strategic and action plans including their coordination and consistency with the city's strategic goals and objectives.

Deliverable: The training materials on the monitoring and evaluation of energy efficiency projects implemented by municipal enterprises

Timeline: October – December 2012

MFSI-II experts have developed the training materials for conducting the monitoring and evaluation of the energy efficiency projects implemented by municipal enterprises.

The main monitoring objectives have been identified as follows:

- regular measurement of interim results and achievements;
- timely detection of any deviations from the set targets;
- timely problem detection;
- timely adjustment of actions to address any detected problems.

The materials explain what data are to be used for conducting monitoring and evaluation, the sources and types of such data. Possible implementers of monitoring and evaluation are described.

The materials contain a classification of the indicators used for conducting the monitoring and evaluation of projects. Thus, the indicators are sub-divided into direct, indirect, qualitative, quantitative, custom, standard, input indicators, activity indicators, outputs, outcomes, and impact indicators. Also, formulas are presented for calculation of basic indicators, and for conducting the monitoring and evaluation of projects. Since the reduction of CO₂ emissions is one of the key indicators for nearly all the energy efficiency projects, the training materials cover the methodology of evaluating a reduction of greenhouse gas emissions resulting from rehabilitation of buildings.

Accomplished (see “Quarterly Report 01 October – 31 December, 2012”)

Deliverable: Report prepared on the number of trainings held and the number of specialists who participated in trainings with a breakdown by gender

Timeline: January – March 2013

On 29 March 2013, MFSI-II experts conducted a seminar: *The Planning and Evaluation Efficiency, Including That of Energy Performance Projects as a Guarantee for Achievement of Strategic Objectives*. The event was attended by the representatives of communal service enterprises and the Executive Committees of City Councils of the project cities.

There were 17 participants total, including 6 women and 11 men.

The participants were introduced to the methodology of monitoring and evaluation of energy performance projects and received recommendations on improving the efficiency of financial justification of strategic documents by communal service enterprises in the context of city development priorities.

The Planning and Evaluation Efficiency, Including That of Energy Performance Projects as a Guarantee for Achievement of Strategic Objectives Seminar, 29 March 2013



A representative from the Kyiv City State Administration (KCSA) was invited to the seminar for experience-sharing. The Deputy Director of Regional and Economic Policy, Head of Strategic Planning and Coordination of Municipal Targeted Programs at the KCSA Department of Economy and Investment Ms. Olha Bazarna has shared with the participants the experience of the City of Kyiv in strategic planning

and its and the city's targeted programs interrelation with budget programs.

The Planning and Evaluation Efficiency, Including That of Energy Performance Projects as a Guarantee for Achievement of Strategic Objectives Seminar, 29 March 2013



Also, the representatives of the cities of Zhytomyr, Ivano-Frankivsk, Lviv, and Chernihiv presented their experience of the communal service enterprises in attracting investments and implementing energy performance projects. To implement these projects, MFSI-II experts have provided assistance to the Executive Committees of the City Councils in preparing the required documents.

For example, Borys Pakholyuk, Director of Municipal Development at the Zhytomyr City Council, made a presentation on implementing energy saving technologies in street lighting in Zhytomyr. A Heating Engineer at the KP Zaliznychneteploenergo Operational Unit Vasyl Terekh reported on the results of investment programs and development prospects of the Lviv-based KP Zaliznychneteploenergo heating utility. Serhiy Kotsur, the Chief Engineer of the KP Chernihivvodokanal water utility told about investments in development of KP Chernihivvodokanal, and Deputy Head of the Production and Process Department at the KP Ivano-Frankivskvodoekotekhprom water utility Ivan Palimon made a presentation on implementation of energy performance projects at the KP Ivano-Frankivskvodoekotekhprom.

Use of knowledge and skills acquired at the seminar will allow the communal service enterprises to apply modern approaches in developing their strategic and planning documents, carry out effective monitoring and evaluation of individual energy performance projects. The experience acquired will make it possible to strengthen the capacity of communal service enterprises in effective planning, management, and implementation of energy saving activities.

Accomplished (see “Quarterly Report 01 January – 31 March, 2013”)

Deliverable: Consultations to the staff of municipal enterprises on using the methodology provided

Timeline: January – September 2013

MFSI-II experts presented a methodology of monitoring and evaluation of energy performance projects and their recommendations for improving the effectiveness of financial justification of strategic documents by communal service enterprises at a seminar held on 29 March 2013. Based on the seminar results, the MFSI-II experts forwarded letters with the presentation materials to the participants to provide their comments and highlight issues.

see “Quarterly Report 01 January – 31 March, 2013”

The MFSI-II Project experts provided recommendations for improving strategic planning in the context of city development priority and a more realistic financial justification to the city of Ivano-Frankivsk Strategic Action Plan of the Ivano-Frankivskteplokomunenergo municipal heating utility for the years 2012-2016.

The recommendations contain certain findings with regard to the linkage between the Strategic Action Plan of the Ivano-Frankivskteplokomunenergo municipal utility for the years 2012-2016 (the “Strategic Plan”) and a comprehensive program of reforms and development of the Ivano-Frankivsk housing and communal services sector for the years 2011-2015 entitled Reforms, Order, Development (the

“Program”). Also, recommendations are provided for improving this Plan in order to set clear linkages between these documents, as well as to improve the level of financial justification of the Strategic Plan.

Among other things, the following recommendations have been provided:

1) The Strategic Plan must contain a list of the projects, which would ensure a transition of some part of heat energy sources to use local and secondary energy resources, or the tasks, which need to be completed to build the company’s capacity to implement such projects.

2) The projects enlisted in the Strategic Plan need to be grouped in accordance with the task list set out by the Program and coordinated with the list of projects identified in the Municipal Plan. For the projects thus grouped, it is necessary to determine:

the indicators of CO2 emission reduction;
economy of natural gas and heat energy;
allocation of investments by source and year.

In general, based on the results of implementation of the Strategic Plan, the indicator of reduction of energy consumption in the heating sector will need to be determined.

3) The Financial Plan, as an integral part of the Strategic Plan, must contain a plan for achievement of company’s financial equilibrium, as well as the mechanisms for attracting investments, including foreign investments, for modernization and technological upgrade of the sector.

To get funds from the State budget, certain actions need to be planned, which should be taken into account in order to pass through all the procedures of project selection according to the law on obtaining such funds.

See folder “Deliverables”

Objective C: Enhance public awareness of the public budgeting process, revenues and expenditures

Task 3.1: Analyze the execution of budgets at all levels and analyze the budget legislation, disseminate impartial information

IBSER will prepare an independent budget implementation and budget legislation analysis to support the efficient and transparent implementation of local budgets. Thus, work will continue to analyze the execution of budgets at all levels and analyze budget legislation. In particular, in order to ensure the monitoring of the impact of the changes to the local revenues legislation, the IBSER will conduct a constant monitoring of the budget process in all of its stages. The results of the monitoring will be presented in monthly and quarterly publications dedicated to the analysis of the budget execution. The results of the monitoring and analysis conducted will be disseminated among all the stakeholders and partners.

Result: IBSER experts will prepare a monthly monitoring of national and local budget implementations and place it on the IBSER’s Web-site (web-page).

Deliverable: Monthly monitoring

Timeline: The monthly monitoring in electronic form is prepared and placed on the IBSER’s Web-site (web-page) by the end of second week of every month

In the reporting timeframe, the project prepared monthly monitoring reports (three for the reported period) on the implementation of the state and local budgets for the period from February 2013 to April 2013 (See “PMP”). The reports were placed on the website. On the whole, there were eighteen monthly



monitoring reports prepared and published on the website since the launch of the MFSI-II Project.

See folder “Deliverables”

Result: *Monitoring of the budget and fiscal impacts on local budgets in form of a full-scale analysis of the budget process*

Deliverable: *Budget Monitoring*

Timeline:

The Monitoring for Quarter 3, 2012 is placed on the IBSER's Web-page by December 31, 2012.

The Monitoring for Quarter 4, 2012 is published, distributed among the IBSER's partners, and placed on the IBSER's Web-page by March 31, 2013.

The Monitoring for Quarter 1, 2013 is placed on the IBSER's Web-page by June 30, 2013.

The Monitoring for Quarter 2, 2013 is published, distributed among the IBSER partners, and placed on the IBSER's Web-page by September 30, 2013.

Result/ Deliverable:

In total, there were six quarterly monitoring reports prepared and published on the website since the beginning of the MFSI-II Project.

According to the State Treasury preliminary data, MFSI Project experts prepared the *Budget Monitoring for January–March 2013* (See “PMP”).

The monitoring included an analysis of the latest trends regarding the State and local budget execution, as well as an analysis of the legislative acts influencing the budget process, approved over the reporting period. *The Budget Monitoring* was distributed among the interested parties and stakeholders, and placed on the website. Key highlights include:

The macroeconomic situation was characterized to a slow-down in economic growth, which was influenced by a decline in development of the global economy in general. The real GDP decreased by 1.1% (in permanent 2007 prices) against the respective 2012 figure, compared to a 2.2% increase in the same period of last year. A decline in the real GDP in Ukraine occurred against a backdrop of this indicator's decline by 0.2% in Eurozone countries and by 0.1% in EU Member-States.

The nominal GDP totaled UAH 301.6bn, which only amounts to 19.1% of the nominal GDP figure used when planning the 2013 State budget. This creates the risk of non-performance of the year's revenue plan in annual terms if the consumer price index is maintained within the target of 4.8%.

A trend is observed towards reduction of industrial production. Thus, the industrial production index amounted to 95.0% vs. 101.8% in the respective period of 2012.

The consumer price index decreased to 101.1%, which is 0.6ppt less than in 2012, and the producer price index increased by 0.6ppt to 100.9%.

The foreign trade balance of Ukraine was a negative one and amounted to \$0.1bn compared to a positive indicator of \$0.8bn in the same period of last year.

The nominal average monthly salary per one full-time employee amounted to UAH 3,080 at the beginning of 2013, which is 9.5% more than last year's figure. This is 2.7 times more than the State social standards (the minimum wage level and employable person's subsistence level of UAH 1,147).

The real wages increased by 9.9% (by 14.7% in 2012).

of last year. Thus, according to official data, the actual intake of the consolidated budget revenues totaled UAH 106.9bn, which is 8.4% more year-on-year and amounts to 22.8%. The intake of State budget revenues totaled UAH 83.8bn, which is UAH 6.6bn or 8.5% more year-on-year. The level of execution of the annual plan amounted to 23.1%.

High levels of execution have been ensured for the enterprise profit tax at 32.4% and excise tax on goods/products made in Ukraine at 24.5%, which is nearly 7.0ppt more than last year. At the same time, the level of execution of the value-added tax decreased to 19.0% or by 2.7ppt, and that of the excise tax on goods/products imported in Ukraine down to 16.7% or by 7.6ppt.

A high level of execution of non-tax revenues was provided, among other things, thanks to the amount remitted to the State budget by the National Bank of Ukraine totaling UAH 4.0bn or 25.0% of the annual plan, and own revenues of budgetary institutions, where the level of execution amounted to 38.4%.

The local budget revenues (without intergovernmental transfers) totaled UAH 23.4bn, which is 8.3% (or UAH 1.8bn) more than in January-March 2012. The level of execution of the revenue plan approved by local councils amounted to 21.9%. Similarly to last year, high dependence is observed of local budgets on intergovernmental transfers from the State budget. Their amount increased to UAH 26.3bn (or by 10.0%). Therefore, the share of intergovernmental transfers in the structure of local budget revenues has reached 53.0%, which is the highest proportion in recent years.

The amount of tax revenues, which equal to 87.3% of local budget revenues (without intergovernmental transfers), totals UAH 20.5bn, which is 10.2% more year-on-year. Growth was demonstrated by all major sources of revenues: personal income tax increased by 6.8%, payment for land by 5.9% etc.

At the same time, the highest growth rate from among all the sources of local budget revenues is demonstrated by the single tax on small businesses, generated at the amount of UAH 1.6bn, which is nearly 1.8 times more than the amount in January-March 2012. It should be noted that this growth mainly occurred due to increased number of payers of this tax, including natural persons and small businesses.

Thanks to the above, the development budget revenues of local budgets grew to UAH 2.5bn or by 10.6%. Inclusion of the single tax into the development budget has had a positive impact on the revenue generation for this budget (the said revenues amounted to 65.2% of all development budget revenues).

The consolidated budget expenditures totaled UAH 112.1bn in Q1 2013. The level of execution of consolidated budget expenditures decreased by 0.3ppt year-on-year and amounted to 21.5%.

The rate of growth of consolidated budget expenditures amounted to 13.2%, which is 4.0ppt less year-on-year. This year, however, it was ahead of the GDP growth rate, which slowed down significantly and only amounted to 2.8%. In the light of this, the share of consolidated budget expenditures in GDP achieved its highest level in January-March in recent years of 37.2%. Also, growth is noted in the share of social expenditures against last year's indicators for all budgets; e.g., it amounted to 67.9% vs. 66.4% for the consolidated budget.

The share of local budget expenditures in the consolidated budget expenditures decreased somewhat

**Structure of Revenues of the Consolidated and State Budgets of Ukraine
in January-March 2011–2013**

(%)

Revenues	Consolidated budget			State budget		
	2011	2012	2013	2011	2012	2013
Tax revenues, including:	86.5	84.7	82.0	87.0	84.5	80.5
– enterprise profit tax	13.6	14.6	17.4	17.4	18.6	22.0
– value-added tax	34.7	32.0	27.4	44.6	41.0	35.1
– excise tax	8.2	8.2	8.7	10.2	10.3	11.0
– taxes on foreign trade and external transactions	2.6	2.7	2.7	3.3	3.4	3.5
Non-tax revenues	12.6	14.6	17.3	12.7	15.3	19.0
Income from capital transactions	0.6	0.4	0.2	0.1	0.1	0.01
Targeted fund	0.3	0.2	0.1	0.2	0.1	0.1
Other revenues	0.0	0.1	0.4	0.0	0.0	0.5

compared to the indicators of January-March 2012 and amounted to 45.1%. It should be noted that the highest share of local budget expenditures in the total structure of consolidated budget since 2006 of 47.4% was recorded in 2012.

State budget expenditures with intergovernmental transfers totaled UAH 87.9bn, which amounts to 21.1% of the annual plan. Increase of expenditures compared to the same period of last year amounted to UAH 6.8bn or 8.4%.

Throughout Q1 2013, the best funded were the expenditures for social protection and social security (24.1% of the annual plan), education (22.2%), and economic activity (21.1%). The lowest indicators of annual plan execution are observed for the expenditures for environmental protection and spiritual and physical development of 14.5% and 14.8%, respectively.

Trends of previous years are preserved in the structure of expenditures in general. For instance, intergovernmental transfers account for the largest share (29.9%); however, this is slightly less (by 1.6ppt) compared to last year's figure.

The share of current expenditures increased by 2.4ppt to 97.7%, which mainly occurred at the expense of allowances to the population for social security, the share of which increased by 4.7ppt and which accounted for about a quarter of all State budget expenditures. The current transfers to government bodies of other levels accounted for 29.3% of all budget expenditures, payroll and taxes accounted for 16.1%, and debt servicing for 8.4%. The share of protected items of State budget expenditures increased to 80.5%, which is 2.7ppt more than the respective 2012 figure. This testifies to State's reduced capacity to incur development expenditures.

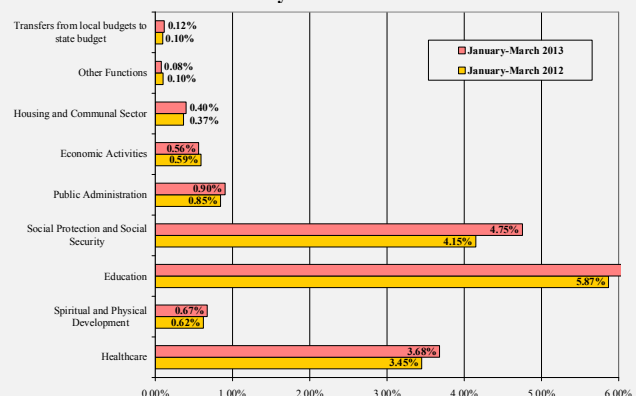
Also, both the scope and level of execution of capital expenditures were reduced. They totaled nearly UAH 2.0bn, which is UAH 1.5bn or 43.5% less than in January-March 2012. The level of their execution decreased by 1.7ppt to 10.4%. Such a decline in expenditures is mainly due to a 58.6% drop in the amount of provided capital transfers, which totaled UAH 1.2bn vs. UAH 2.8bn in Q1 2012.

The local budget expenditures (with intergovernmental transfers) increased by nearly 7.7% and totaled UAH 50.9bn. The level of execution of the January-March plan approved by local councils amounted to 22.5%. As usual, the majority of local budget expenditures were channeled to the social and cultural sector. At the same time, expenditures for intergovernmental transfers increased (+22.2%) in Q1 2013.

The expenditures for payroll with taxes increased by 7.3% and amounted to UAH 22.7bn. Also, expenditures for medicines and bandaging materials increased by 10.2%, and those for foodstuffs by 8.3%, with the funding of UAH 683.7mn and UAH 1,342.0mn, respectively. At the same time, the expenditures for utilities and energy decreased by 10.7% or by UAH 614.4mn, and capital expenditures by UAH 135.6mn or by 5.4% down to UAH 2.4bn.

A 1.5ppt growth in noted in the economic structure of expenditures for the share of current transfers to the population for social security of up to 25.0%. The percentage of expenditures for payroll with taxes, which is typically the largest from among all the local budget expenditures, remained nearly unchanged and amounted to 44.6% in Q1 2013. The share of expenditures for utilities and energy decreased by 2.0ppt and amounted to 10.1% of all local budget expenditures.

**Share of Local Budget Expenditures in GDP
in January-March 2012-2013**





The State budget deficit totaled UAH 4.5bn, which amounts to 13.2% of the ceiling set by the Law of Ukraine "On the State Budget of Ukraine for the Year 2013."

The State budget borrowing totaled UAH 44.2bn or 1.9 times more year-on-year. The annual borrowing plan was implemented by 32.6%. **Debt repayment** totaled UAH 14.7bn or 18.1% of the annual plan and 1.4 times more year-on-year. The excess of borrowing over repayment increased by 127.0% compared to last year. At the same time, nearly a half of these funds was not spent in the first quarter and could be used either for debt repayment or for planned financing of the budget deficit in subsequent months.

According to the State Treasury Service of Ukraine, **the amount of loans for covering temporary cash flow gaps of local budgets** at the expense of funds in the Single Treasury Account totaled UAH 8.3bn, which is 8.8% more year-on-year.

The proceeds from privatization of State property totaled UAH 25.8mn (0.2% of the annual plan) compared to UAH 4.1bn last year (or nearly 41.0% of the annual plan).

The balance of budget funds totaled UAH 43.4bn at the end of March 2013, having increased by UAH 16.3bn since the beginning of the year. The balance decreased by 15.0% compared to the same indicator of last year.

See folder "Deliverables"

Task 3.2: Conducting public events and engaging the public in the budget process

In order to efficiently engage the public in the budget process and sound the public opinion, IBSER will support the holding of public hearings. IBSER will continue its practices of holding meetings of the National Advisory Board and the Financial and Economic Forums on an ongoing basis with an invitation extended to all interested parties, including to representatives of the general public. In order to ensure the broadest possible dissemination of information at the local level and raising the level of public awareness, use will be made of all available mass media and other formats, such as holding of public hearings, publication of printed materials etc

Result/Deliverable:

Participation of IBSER experts in working meetings, roundtables, conferences, including international ones, radio and TV talk shows with the aim of disseminating information on the issues addressed by the project

Timeline: Ongoing process

On **17 October 2012**, the MFSI-II Project took part in a meeting of the Economic Reform Committee on Progress in Implementing Reforms of the Administrative Services System in the City of Kyiv.

The meeting, chaired by the Head of the Kyiv City State Administration (KCSA) Oleksandr Popov, took place at the KCSA office. The attendees included members of the Economic Reform Committee, heads of district State administrations in the city of Kyiv, Principal Directorate of Regulatory Policy and Entrepreneurship of the Kyiv City State Administration, and managers of Kyiv communal service enterprises.

It should be noted that the MFSI-I Project had assisted in developing the reform of the Kyiv city administrative system. Among other things, the Project analyzed the status and management of administrative service provision within the Kyiv city budget. The analysis' findings included an imperfect organizational structure in terms of administrative services provision and a non-uniform structure of

services and the organizations providing these services. This hampers the implementation of effective management in the budgetary sphere.

The conclusions from MFSI-I were taken into account in the course of reform implementation. For example, the number of key spending units was reduced from 166 in 2010 to 49 in 2011. Moreover, about 50 budget programs on public administration were developed and approved in the city of Kyiv in 2012. MFSI-II experts take part in the working meetings and monitor performance of the developed recommendations.

Implementing PPB in the city has also made it possible to compare budget expenditures for the provision of organizational services in terms of their quality and effectiveness. All the expert groundwork has been incorporated by KCSA in the reform implementation plan.

Discussed at the meeting were such important issues as: allocating funds in the draft Kyiv 2013 municipal budget for implementation of the Law of Ukraine “On Administrative Services”; funding the City Permit Center and district centers of administrative services; mechanisms and special features of service provision, and the need to make coordinated decisions with the administrative service provision entities via the Kyiv administrative service centers.

A protocol resolution was prepared based on the meeting results. It designates the tasks and activities to be undertaken to address the urgent needs and sets the deadlines for their completion as well as the persons in charge.

Accomplished (see “Quarterly Report 01 October – 31 December, 2012”)

On **15 November 2012** MFSI-II Experts Took Part in Healthcare System Reform Meeting. The Deputy Prime Minister of Ukraine Rayisa Bohatyryova chaired a meeting with the directors and finance officers of oblast and Crimean health departments, as well as finance officers of health departments of oblast-significant cities. Among other things, the meeting participants considered the issue of Using the Performance Program Budgeting Method: Interaction between the Central and Regional Levels. Also, the participants in the meeting discussed the progress in implementation of programs and activities in the sector of public health in 2012. Thus, according to the Ministry of Health, thanks to realization of budget programs in healthcare, the savings achieved totaled UAH 84.5mn in 2012.

Accomplished (see “Quarterly Report 01 October – 31 December, 2012”)

IBSER is working continuously to strengthen its institutional capacity and is looking for new opportunities of financing its institutional development according to its Capacity Development Plan, which is completed in the second Quarter of 2013.

With this in mind, IBSEr took part in the First Capacity Development Forum, which was held in Kyiv on **19 November 2012**. The Forum participants familiarized themselves with the latest tools and trends in the field of the institutional development of NGOs, shared best practices, and learned in greater detail about the activities of NGO Market and the Voucher System.

Accomplished (see “Quarterly Report 01 October – 31 December, 2012”)

On **14 February 2013** the Zhytomyr’s mayor invited IBSEr Director General Iryna Shcherbyna and MFSI-II Project Coordinator Andriy Nesterenko (USAID) to attend a signing ceremony of the Guarantee Agreement between the European Bank for Reconstruction and Development (EBRD) and the City of Zhytomyr under the Development of the Zhytomyr City Heating System project. The signing took place at the EBRD Ukraine office.

Thanks to assistance from the Municipal Finance Strengthening Initiative (MFSI-II) Roll-out Project, the city of Zhytomyr had received approval from the Ministry of Finance of Ukraine to incur debt for implementing the Development of the Zhytomyr City Heating System project. Implementing this project



will have a significant social and economic impact, among other things, thanks to the improved provision of heating and hot water supply services to city residents through the increased operational reliability of the Zhytomyrteplokomunenergo municipal heating utility.

Accomplished (see “Quarterly Report 01 January – 31 March, 2013”)

On **5-6 March 2013** the MFSI-II Project took part in Information Fair 2013, which was organized by the Verkhovna Rada and USAID.

IBSER exhibits at the Fair included items such as printed budget monitoring publications, quarterly reports on the main budget and economic trends. These materials have been created thanks to the methodological groundwork developed under MFSI and MFSI-II projects.

Participation in the Fair provided an opportunity to present the MFSI and MFSI-II projects and their products to a wider community of experts and familiarize MPs and staff of various parliamentary factions with project activities, which would help attracting new partners for future collaboration. The Fair’s visitors had ample opportunity to talk to MFSI-II representatives and receive the materials they were interested in.

Accomplished (see “Quarterly Report 01 January – 31 March, 2013”)

The MFSI-II Project took part in a meeting of Ukraine’s municipal finance officers, which was held in Dnipropetrovsk on **14 and 15 March 2013**. The event was organized by the Association of Ukrainian Cities as part of the USAID Development Initiative for Advocating Local Governance in Ukraine (DIALOG) Project.

The meeting was held to identify the ways of strengthening the financial basis of local government and to review legislative drafts to amend budgetary and tax laws.

The Project took part in discussing the following draft laws:

On amending the Budget Code of Ukraine and several other State-level legislative acts regarding the normalization of the list of revenues and expenditures of local budgets;

On amending the Budget Code of Ukraine to improve the mechanism of planning by the Ministry of Finance of local budget revenues that are taken into account when determining the amount of intergovernmental transfers;

On amending the Budget Code of Ukraine to improve the State Treasury servicing of local budgets;

On amending the Tax Code of Ukraine regarding the collection of payments for land;

On amending the Tax Code of Ukraine and the Commercial Code of Ukraine regarding the normalization of personal income tax payments by separated divisions of legal entities.

As a result of the meeting, proposals will be compiled with regard to amending the legislation as well as the proposals for adjusting the indicators of the Law of Ukraine “On the State Budget of Ukraine for the Year 2013” with regard to local budgets and interbudgetary relations.

Accomplished (see “Quarterly Report 01 January – 31 March, 2013”)

On **January 31, 2013**, IBSER experts participated in the round table “Immovable property tax” conducted by the Ministry of Finance of Ukraine. IBSER experts indicated the loopholes of the current provisions of the Tax Code chapter regulating the immovable property tax levying and formulated the possible ways of eliminating these loopholes. The proposals were provided to the representatives of the Ministry of Finance and Ministry of Revenues.

Accomplished (see “Quarterly Report 01 January – 31 March, 2013”)

The city of Zhytomyr in its letter to USAID requested MFSI-II Project assistance in implementing the financial mechanisms required for using savings in energy carriers.

After USAID approval, the Project met with the Mayor of Zhytomyr **on 25 April 2013**. The meeting was also attended by the representatives of various departments from the Executive Committee of the Zhytomyr City Council and the city's communal service enterprises.

The participants discussed two issues that are important for the city. The first issue is how to implement the financial mechanisms required in order to use the budget funds for energy carriers saved as a result of implementing energy saving projects. The second issue deals with the system of financial incentives for the efficient use of energy resources by the municipality's budgetary institutions.

As a result of this meeting, modifications will be made to the Memorandum of Cooperation with the city of Zhytomyr. As part of this work, the Project will provide the city with a study justifying the ability to use the savings in energy carriers under the existing legislation and recommendations for planning heat consumption costs, provide methodological support, and develop draft City Council resolutions and other normative documents on this matter.

This partnership will make it possible to create an effective system of energy savings in the public sector, more efficiently use municipal budget resources, and improve the level of funding for its energy performance projects.

Upon invitation from the Ministry of Finance of Ukraine, MFSI-II took part in a meeting of the Interdepartmental Working Group on development of public finance management system **on 17 May 2013**. The meeting participants reviewed the Draft Strategy for Development of Public Finance Management System, which incorporates the proposals suggested by MFSI-II experts for further PPB implementation.

In addition, MFSI-II has developed and submitted for consideration a separate section of the Strategy entitled Energy Dependence of Budgets. This section is intended to reduce the energy dependence of budgets through the use of:

- mechanisms for accumulation of savings in energy payments;
- mechanisms of financial stimulation of economical use of energy resources in budgetary institutions;
- systematic methodology of monitoring and evaluation of efficiency of expenditures for utilities and energy etc.

Based on the meeting results, the participants have decided to hold a number of meetings during the next two weeks for detailed discussion of each individual proposal to the Strategy, including the proposals of MFSI-II, with the representatives of the Ministry of Finance of Ukraine.

Approval of the Strategy will not only set out the topical areas for improvement of the system of country's public finance, but also the ways and activities for implementation of its direct reform. Such a Strategy will become an important step towards further strengthening of the transparency of budget relations.

A scheduled meeting of the task force on interbudgetary relations reform with regard to developing the methodological foundations for implementation of the Performance Program Budgeting method of formulation and execution of local budgets was held at the Ministry of Finance **on 27 May 2013**. The meeting was attended by MFSI-II experts, specialists of the Ministry of Finance of Ukraine and the State Treasury Service.

Discussed at the meeting were the topical issues of improving the treasury servicing of PPB-based budgets. In the course of the meeting, the MFSI-II experts suggested conceptual changes to the classification of expenditures and crediting of local budgets, which would allow conducting the treasury servicing of budgets in accordance with the PPB requirements. In addition, the participants considered the issues of the progress in preparation for field-testing of the Local Budgets Information Analysis System software.

Based on the meeting results, the specialists have set out the approaches with regard to amending the



classification of expenditures and crediting of local budgets, as well as the forms of individual documents to be used in the process of planning and execution of local budgets based on PPB. These documents will be used as the basis for field-testing of the relevant software in the pilot Zhytomyr oblast.

The resolution of these issues will ensure use of appropriate software for planning, approval, and execution of PPB-based local budgets starting in 2014.

On 14 June 2013, the MFSI-II experts took part in a working meeting with specialists of the State Treasury Service. Discussed at the meeting were the MFSI-II proposals on improving the forms of reports on execution of local budgets. In addition, the participants reviewed the changes to the classification of expenditures developed by the MFSI-II project.

Introduction of the new reporting forms and changes to the classification of local budget expenditures as of 1 January 2014 will improve the Treasury servicing of local budgets and ensure a transparent generation of reports in the PPB format.

On 20 June 2013, the National Communal Services Regulatory Commission held a meeting of its legislative development Board.

MFSI-II experts were also invited by the Commission to take part in the meeting. During this event, the participants reviewed the amendments to the Budget Code of Ukraine developed by the Commission jointly with the MFSI-II experts. The amendments to the core budget law will make it possible for the first time to settle the problem issues, which prevent from the introduction of energy performance contracts at the legislative level.

At the meeting, People's Deputies, representatives of the Commission, scholars and experts of NGOs reviewed and supported on the whole the proposed legislative draft.

The adoption of such amendments will remove obstacles for engagement of private capital in energy saving activities in budgetary institutions. First of all, they would allow to establish an interrelation between the savings achieved in budgetary institutions and reimbursement of costs of energy performance services. Establishment of such a link will guarantee transparent rules when reimbursing investor's costs. Also, the adoption of these amendments would allow making payments to investor during periods longer than one year.

On the whole, adoption of the said amendments to the legislation would allow to:

- Introduce a transparent and clear arrangement for negotiating and implementing energy performance contracts;
- Improve attractiveness of the public sector for potential investors in the field of energy saving by guaranteeing protection of their rights; and
- Reduce energy dependence of Ukrainian municipalities.

Result: Preparation and organization of Financial-Economic Forum

Deliverable: Minutes of Financial-Economic Forum, agenda and recommendations of Forum participants

Timeline: February 2013, September 2013

The Eleventh Financial and Economic Forum on the topic Energy Efficiency of Budget Expenditures: the Road to Economic Prosperity will be held on April 2013.

During the event participants will review and discuss legal and best practice issues related to the implementation of energy saving projects, financial incentive mechanisms that promote the efficient use of energy resources, and alternative funding sources for energy saving projects, as well as how to strengthen the financial capacity of local budgets and improve the investment attractiveness of cities and towns.

A detailed description of this event and developed recommendations will be presented in the next quarterly report.

Accomplished (see “Quarterly Report 01 January – 31 March, 2013”)

The Eleventh Financial and Economic Forum on Energy Efficiency of Budget Expenditures as a Road to Economic Prosperity was held **on 5 April 2013**.

The Forum was attended by representatives of Ministry of Economic Development and Trade of Ukraine, USAID, Ministry of Finance of Ukraine, National Public Utilities Regulatory Commission, Association of Ukrainian Towns, international financial organization and other leading experts of government ministries and departments, local governments, representatives of the academia, international expert community, and the civil sector.

In the course of the Forum, the participants reviewed and discussed the topical issues related to the legal foundations and modern practices of implementation of energy saving projects, mechanisms of financial incentives for efficient use of energy resources, and alternative funding sources for energy saving projects, as well as the ways of strengthening the financial capacity of local budgets and improving the investment attractiveness of cities and towns.

Based on the forum’s active discussion, recommendations were drafted and disseminated among all the stakeholders and published on the MFSI-II website.

See folder “Deliverables”

The Eleventh Financial and Economic Forum, 5 April 2013



Result: Preparation and organization of a National Advisory Board

Deliverable: Minutes of a National Advisory Board and agenda

Timeline: December 2012, March 2013, June 2013, August 2013

On 25 December 2012, MFSI-II experts organized and conducted a meeting of the National Advisory Board (NAB) on efficient public finance management.

During the meeting, the participants discussed the main directions of work and tasks of the experiment on implementation of the Performance Program Budgeting method at the level of local budgets in 2013. Special focus was made on the results of evaluation of the PPB implementation experiment for local budgets. Also, based on the results of the discussion, the participants set out further ways of conducting the preparatory work required for implementing the treasury servicing of the local budgets formulated according to PPB.

Meeting of the National Advisory Board (NAB) on efficient management of public finance, 25 December 2012



Accomplished (see “Quarterly Report 01 October – 31 December, 2012”)



A meeting of the National Advisory Board on effective public finance management was held on 29 March 2013.

The meeting was attended by the representatives of the Ministry of Finance of Ukraine and the State Treasury Service of Ukraine. The meeting participants discussed the issues of amending the program classification and provisional classification of local budget expenditures. Additional elaboration of the classifications is needed to be used as of 2014 for the formulation and execution of PPB-based local budgets. In particular, to ensure uniformity of the budget process in Ukraine and adapt to the program classification, experts of the MFSI-II Project have proposed to amend the provisional classification of local budget expenditures.

To implement the provisions of the Presidential Program of Economic Reforms for the Years 2010-2014 and Project's Work plan, MFSI-II experts have proposed and agreed with the meeting participants to make appropriate changes to the treasury reporting forms on execution of local budgets. The proposed modifications will ensure preparation of reliable and transparent reports based on PPB by offices of the State Treasury Service.

Special focus of the meeting was made on discussing the practical aspects of implementation of monitoring and evaluation of efficiency of execution of local budget programs. As the result of the discussion, the participants agreed to test the methodology of evaluating the efficiency of implementation of budget programs in individual pilot regions based on the 2012 data. This will ensure testing of the methodology (developed by MFSI-II experts) and allow to analyze the status of implementation of budget programs.

Implementation of monitoring and evaluation and the methodology in local budgets will make it possible to improve the effectiveness of analysis of local budget execution and transparency of the budget process in Ukraine.

Meeting of the National Advisory Board (NAB) on efficient management of public finance, 29 March 2013



Accomplished (see "Quarterly Report 01 January – 31 March, 2013")

On 25 June 2013, the Ministry of Finance held a joint meeting of the Task Force on interbudgetary relations reform and the National Advisory Board on effective public finance management. The meeting was attended by the representatives from the Ministry of Finance, State Treasury Service, MFSI-II Project, academia, NGOs, and international organizations.

The participants discussed issues related to improving the regulatory and methodological framework of PPB application at the level of local budgets, as well as the results of a pilot project on the methodology of comparative analysis of efficiency of budget programs.

The Project and the Ministry of Finance have suggested that the procedures of public finance reporting and accounting at the national and local levels be unified. To this end, they have developed a standard program classification of expenditures and crediting of local budgets, which is fully in line with the structure of program classification at the State budget level.

Approving the proposed changes will make it possible for the first time to keep local budget records by program in the PPB format in full conformity with the State budget. Also, unifying budget classifications would enable the budget process to be automated at all levels through the development of the appropriate software.

Unifying and automating the approaches to the formation of both the State and local budgets will improve the transparency of the budget process and strengthen controls over the management of budget funds. In addition, the approval of the new classification will provide an opportunity to start using it as of 1 January 2014 with the introduction of a fully functional planning and execution of PPB-based local



budgets.

The meeting's participants supported the new approaches and recommended that the appropriate amendments should be made to all documents used in the budget process.

At the meeting, the Project presented the results of the pilot project on the methodology for a comparative analysis of the efficiency of budget programs.

This methodology was developed by the MFSI-II experts in collaboration with the Ministry of Finance and disseminated among all experiment participants. The methodology provides for a formula-based approach to evaluating the efficiency of budget program execution. The Project ran a pilot project with the methodology using annual reports on the execution of budget program passports for four local budgets. The test's results have proven the effectiveness of the methodology for evaluating budget programs.

The meeting participants approved the materials presented and emphasized that the introduction of such a methodology will make it possible to impartially analyze budget program execution efficiency in general as well as the individual tasks within them. It will provide a toolkit for top officials to make informed managerial decisions when allocating budget funds. This, in turn, will lead to improved transparency and efficiency in the planning and execution of PPB-based budgets.

See folder "Deliverables"

Result/Deliverable: Regular updating of IBSER's website with information regarding project activities

Timeline: Ongoing process

The MFSI-II web-site is updated on a regular basis with information regarding MFSI-II project activities in Kyiv and in the regions (Ukrainian, Russian and English pages). In particular, the following sections:

News:

all news and events where MFSI-II project experts participated in the period October – December 2012 are written, placed and updated on the site.

Research and Materials:

All MFSI-II project periodic publications (its electronic versions), prepared in the period October – December 2012, have been placed on the site in the Subsection – "Analytical materials" (Ukrainian and English versions).

Useful References (subsections – Media about us; Our Partners).

All monitored articles published in national and regional media in October – December 2012 have been converted into electronic version, placed on the site and updated on a regular basis (Ukrainian and English versions).

New set of questions in section "Experts' answer" with experts answers related to PPB section has been regularly added on the site, the information is regularly updated.

The section of the Monitoring of Legislative Changes, which periodically covers the information regarding changes in the Ukrainian legislation is updated.

Accomplished (see "Quarterly Report 01 October – 31 December, 2012")

The MFSI-II web-site is updated on a regular basis with information regarding MFSI-II project activities in Kyiv and in the regions (Ukrainian, Russian and English pages). In particular, the following sections:

News:



All news and events where MFSI-II project experts participated in the period January – March 2013 are written, placed and updated on the site.

Research and Materials:

All MFSI-II project periodic publications (its electronic versions), prepared in the period January – March 2013, have been placed on the site in the Subsection – “Analytical materials” (Ukrainian and English versions).

Useful References (subsections – Media about us; Our Partners).

All monitored articles published in national and regional media in January–March 2013 have been converted into electronic version, placed on the site and updated on a regular basis (Ukrainian and English versions).

New set of questions in section “Experts’ answer” with experts answers related to PPB section has been regularly added on the site, the information is regularly updated.

The section of the Monitoring of Legislative Changes, which periodically covers the information regarding changes in the Ukrainian legislation is updated.

Accomplished (see “Quarterly Report 01 January – 31 March, 2013”)

The MFSI-II project web-site is updated on a regular basis with information regarding MFSI-II project activities in Kyiv and in the regions (Ukrainian, Russian and English pages). In particular, the following sections:

News:

All news and events where MFSI-II project experts participated in the period April – June 2013 are placed on the site.

Research and Materials:

All MFSI-II project periodic publications (its electronic versions), prepared in the period April – June 2013, have been placed on the site in the Subsection – “Analytical materials” (Ukrainian and English versions).

Useful References (subsections – Media about us; Our Partners).

All monitored articles published in national and regional media in April – June 2013 have been converted into electronic version, placed on the site and updated on a regular basis (Ukrainian and English versions).

New set of questions in section “Experts’ answer” with experts answers related to PPB section has been regularly added on the site, the information is regularly updated.

The section of the Monitoring of Legislative Changes, which periodically covers the information regarding changes in the Ukrainian legislation is updated.

Result: Preparation of Electronic bulletin intended for the publication of news on project activities for electronic mailing to addressees in the database of IBSEER partners

Deliverable: Electronic bulletin

Timeline: October 2012, January 2013, April 2013, July 2013

One Bulletin issue (#37- January-March 2013) has been prepared in Ukrainian and English and e-mailed to more than 570 partners. It is also placed on the project web-site in “E-Bulletin” section. Overall, five Bulletins have been prepared since the launch of the MFSI-II Project.

See folder “Deliverables”

Result/Deliverable: Publication «Innovative Practices of the Local Finance Management».

Timeline: March 2013

MFSI-II experts have prepared an annual publication of *Innovative Practices: Local Finance Management – 2012 Results*, which provides illustrations of the results of execution of budget programs and energy performance projects, and highlights the successful experience of realization of strategic programs and PPB implementation. The publication is intended for a wide audience and is expected to help popularize the achievements and best practices of PPB at the local level.



Accomplished (see “Quarterly Report 01 January – 31 March, 2013”)

Result: Support the holding of separate information public events in partner cities

Deliverable: The report on implementation of information public events in localities prepared

Timeline: February 2013, August 2013

A roundtable discussion on the topic *The Initial Results from Implementation of the Performance Program Budgeting Method in the City Budget Process* was held in Kalush, Ivano-Frankivsk oblast, on 21 February 2013. This public event was attended by the representatives of the deputy corps of the City Council, key spending units of the city budget, and representatives of mass media.

In the course of the meeting, the participants discussed the important issues of PPB implementation, characterized by the efficiency of using the budget funds, shared their experience of formulation of budget programs, and outlined the benefits from efficient monitoring and evaluation.

Holding of a public discussion of the said issues made it possible to improve the transparency in execution of the city budget and inform the general public about the results of conducting the experiment of PPB implementation.

On 27 and 28 March 2013, within a training seminar for the representatives of the Finance Directorates of the Kharkiv oblast, a public presentation on PPB budgeting took place. Based on the results of this presentation, information was published on the website of the Kharkiv Oblast State Administration. A more detailed information is available at: <http://kharkivoda.gov.ua/uk/news/view/id/16950/>

Accomplished (see “Quarterly Report 01 January – 31 March, 2013”)

Result: Delivery of training on budget issues for NGOs

Deliverable: Report on the number of trainings held and the number of participants attending the trainings with a breakdown by gender

Timeline: January – March 2013.

On 9 November 2012, as part of the training organized with support from the UNDP program in Lviv, on the topic of *Strengthening Responsibility for Financing of Gender Equality*, MFSI-II experts delivered a training for representatives of non-governmental organizations. There were a total of 18 representatives of non-governmental organizations and representatives of local governments, who took part in the training (see PMP).



MFSI-II experts covered the issues of the gender component in developing and disseminating the Performance Program Budgeting method to local budgets of Ukraine. They highlighted the opportunities offered by the Performance Program Budgeting method, which allow implementing the gender policy in the country in the most successful manner.

This training has helped strengthening the capacity of gender experts, leaders of civil society organizations, and local governments to provide efficient financing to address the problems of gender equality.

Accomplished (see “Quarterly Report 01 October – 31 December, 2012”)